No. 557

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

IDA C. HAZZARD, ET AL., Petitioners,

v.

THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF NEW YORK

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Petitioners,

against

THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF NEW YORK

TO THE HONORABLE, THE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Petitioners, plaintiffs below, one hundred and twenty-five debenture holders of National Electric Power Company[1] are resident throughout the United States and include National and State banks[2]. They pray that a writ of certiorari issue to review the final judgment, entered on March 22, 1940 (R. 3692-3694), upon the remittitur of the Court of Appeals, the highest Court of New York State (R. 3690-3691), affirming intermediate New York State Court judgments entered July 13, 1939 (R. 3686-3687) and July 1, 1936 (R. 142-143) in favor of The Chase National Bank of the City of New York,[3] dismissing petitioners' complaint on the merits, following an equity trial.

Opinions Below

The opinion of the Trial Court is reported in 159 N. Y. Misc. 57 (R. 3635-3678). The Appellate Division of the New York Supreme Court, in affirming, some six months after argument, wrote no opinion (257 N. Y. App. Div. 950; R. 3684-3685). At its next term, it granted leave to appeal to the Court of Appeals, certifying "that in its opinion a question of law is involved which ought to be reviewed" (258 N. Y. App. Div. 709; R. 3683-3684). The Court of Appeals in affirming, wrote no opinion; Rippey, J. dissenting without opinion, and Finch, J. taking no part (282 N. Y. 652; R. 3690-3691). In denying petitioners' motion for re-argument and amendment of the remittitur, the Court of Appeals, however, wrote a short memorandum opinion which is reported in 283 N. Y. 132 (R. 3705).

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[1]Hereinafter called "NEP".

[2]e.g. Bay Trust Company of Michigan (R. 9); Ridgeway State Bank of Illinois (R. 10); Peoples Savings Bank of Wisconsin (R. 21); Kent National Bank of Washington (R. 30). The suit was instituted in 1933 under the auspices of the Bondholders Protective Committee of Boston, Massachusetts (R. 373-375).

[3]Hereinafter called "CHASE NATIONAL".

Jurisdiction

1. The jurisdiction of this Court rests on Section 237 of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. A., Sec. 344).

2. Final judgment was entered on March 22, 1940 (R. 3692-3694) upon the New York Court of Appeals remittitur (R. 3690-3691). On May 24, 1940, petitioners seasonably applied to the Court of Appeals for re-argument, amendment of the remittitur and other relief (R. 3707-3723). This motion was denied on June 11, 1940, "on the ground that it does not present either authority or reason for changing our decision" (R. 3705; cf. *Gypsy Oil Co.* v. *Escoe,* 275 U. S. 498; *United States* v. *Seminole Nation,* 299 U. S. 417). On September 6, 1940, this Court by order signed by Justice Black, extended petitioners time to file the instant petition and record for sixty days from September 11, 1940 (R. 3724; cf. 28 U. S. C. A. 350).

3. The following authorities sustain the jurisdiction of this Court since petitioners specifically set up Federal rights under a Federal statute: *National Banking Act,* 12 U. S. C. A.; *M'Culloch* v. *Maryland,* 4 Wheat. 316; *Osborn* v. *Bank of United States,* 9 Wheat. 738; *Easton* v. *Iowa,* 188 U. S. 220; *Yates* v. *Jones National Bank,* 206 U. S. 158; *Jones National Bank* v. *Yates,* 240 U. S. 541; *First National Bank* v. *Fellows, Ex Rel. Union Trust Co.,* 244 U. S. 416; *Missouri Ex Rel. Burnes Nat. Bank* v. *Duncan,* 265 U. S. 17; *Ex Parte Worcester County Nat. Bank,* 279 U. S. 347; *Awotin* v. *Atlas Exch. Nat. Bank,* 295 U. S. 209; *Deitrick* v. *Greaney,* 309 U. S. 190; *Inland Waterways Corp.* v. *Young,* 309 U. S. 517; *City of Yonkers* v. *Downey,* 309 U. S. 590; *Colorado National Bank* v. *Bedford,* 310 U. S. 41.

Also the decision below was arbitrary and capricious, in violation of settled principles of law, contrary to undisputed facts, and in disregard of formal concessions by Chase National, petitioners were unconstitutionally de-

prived of their property, without due process of law, as required by the Fourteenth Amendment (cf. *Scott* v. *McNeal,* 154 U. S. 34; *Postal Tel-Cable Co.* v. *Newport,* 247 U. S. 464; *Williams* v. *Tooke,* 108 F. (2d) 758; cf. *Schofield, Federal Supreme Court and State Law,* 3 Ill. L. Rev. 195).

4. The questions involved are substantial. This will clearly appear from the "Statement" *infra.* Should this Court determine that any National Bank trustee, under Federal law and policy, is a fiduciary, subject to a Federal standard of minimal duties and disabilities springing from the fiduciary relationship, then, upon the findings below (even excluding formal concessions and undisputed facts) it inevitably follows that CHASE NATIONAL must be removed as trustee and held to account.

This cause was tried and submitted by petitioners and CHASE NATIONAL upon the basic recognition that any trustee is a fiduciary. CHASE NATIONAL, conceded in writing at the trial "that a corporate trustee may have certain *implied* "duties beyond those expressly imposed on it by the trust in- "denture" (R. 1808; 1805-1809). Nevertheless, the Trial Court, in an opinion written weeks after the trial, held that the word "trustee" is a "misnomer"; that "undivided "loyalty" was not required; that this trustee's "duties" were "defined, not by the fiduciary relationship, but exclusively "by the terms of the agreement"; that its "status" is more that of a "stakeholder" and that the "rule of trustee and "*cestuis* is not the one to be applied here, either by agree- "ment or implication" (R. 3674-3675; 3672). He clearly recognized that were CHASE NATIONAL invested with the slightest of the duties or disabilities of any fiduciary, it would be removed and required to account, since "the acts "of the trustee would be a distinct violation of the well- "recognized obligations arising from such relationship" (R. 3666).

There was thus created the concept of a non-fiduciary trustee. This cast aside the ancient and universal law and

equity jurisprudence of trusts and fiduciaries. The State Courts' basic error followed. CHASE NATIONAL, this trustee, was not charged with the minimal fiduciary duties of "un-"divided loyalty (R. 3672-3675) and "full disclosure." There were thereby stripped from the shoulders of this "inconsistent", "negligent" and damaging trustee (R. 138), the fundamental "burdens of explanation and justification" (R. 3674). Instead there was thrust upon the bondholders (the *cestuis*), themselves, the burden of proving by a preponderance of evidence that "bad faith" predominated in the minds of the trustee's officers and agents; their evil intent; their "mental "attitude of reckless and wanton disregard of the rights of "others" (R. 3646; 3654; 3666; cf. R. 3712-3714).

Upon the application for re-argument and amendment of the remittitur, petitioners' Federal rights and claims were squarely presented (R. 3714). CHASE NATIONAL opposed, not upon the merits, but by oblique suggestions that if the amendment be denied, then the *cestuis* might be impeded in obtaining a review in this Court (R. 3699-3705; cf. 3694-3698). Thereupon, the Court of Appeals, in denying the motion, wrote a one sentence opinion. It contains self-contradictory statements, to wit "the liability of the corporate "trustee though acting as a fiduciary was limited by the "terms of the trust agreement." The "ground" of the denial was that the motion "does not present either authority "or reason for changing our opinion" (R. 3705). Clearly, the Court of Appeals considered and passed upon the Federal questions presented.

There can be no "fiduciary" without fiduciary duties or disabilities. By very definition a fiduciary is one upon whom there are duties imposed by law. These transcend and rise superior to contractual limitations. A fiduciary without fiduciary obligations, or those which can be obliterated by contract, is no fiduciary in any sense of the term.

CHASE NATIONAL, in its most recent interpretation of its own status, wrote: "Whether the trustee was a national "bank, a state bank or an individual was immaterial in this

"case" (R. 3701). That statement is a challenge. Upon the findings, concessions and undisputed facts, is it "immaterial "in this case" that petitioners were betrayed by a National Bank fiduciary trustee and not by a State bank or an individual? Under Federal law and policy can minimal duties and disabilities of a National bank fiduciary trustee be abridged by contract or by State fiat?

5. Due to the unusual way in which the Federal questions were first eliminated by concession, then restored by a disregard of that concession, again eliminated in the Appellate Courts by similar concessions, and again restored by similar disregard, it is necessary fully to explain the sequence of events to show the stage at which the Federal questions were raised, the manner in which they were raised, and the way they were passed upon below:

(a) The Federal standard of the minimal duties and disabilities of a National bank fiduciary trustee, is essentially a Federal question and necessarily existed throughout the case. The very first finding (proposed by CHASE NATIONAL), predicated upon an issue raised by the pleadings, determined that CHASE NATIONAL was a "National Banking Corporation "duly organized and existing under the laws of the United "States" (R. 45-46; 223-224).

(b) Throughout the trial, there was no issue respecting the legal proposition that any trustee (National bank or otherwise) is a fiduciary, charged by law with minimal duties and disabilities springing from the relationship, regardless of the words of the trust indenture. This was then conceded in writing by CHASE NATIONAL (R. 1808). The issue tried was whether, in fact, there had been a breach of such conceded duties. These were abundantly proved and expressly found (cf. "Statement", *infra*). Upon the theory of the trial, such breaches should have required the removal of the trustee and its compulsion to account.

However, weeks after the trial, the Trial Court changed the conceded theory of the trial. In his opinion, CHASE NA-

TIONAL was condemned, but relieved from liability because it was then determined that a mortgage indenture trustee was no fiduciary at all (e. g., R. 3674-3675; 3672).

In the Appellate Division, and despite the Trial Court's metamorphosis of the case, CHASE NATIONAL repeated its prior concessions.[4] Petitioners could scarcely argue to that Court what the effect would have been for a National bank trustee to deny that it was a fiduciary, while that National Bank continued to concede that basic proposition. These concessions were not withdrawn in the Court of Appeals (R. 3713).

When the majority of the Court of Appeals affirmed without opinion, and the dissent was without opinion, the *ratio decidendi* was still unknown. Therefore petitioners expressly presented to the Court of Appeals the Federal questions and repercussions involved in a determination that a National bank, acting as a trustee, was no fiduciary. That Court then stated that the argument and direct presentation of the Federal questions did "not present either authority or rea-"son for changing our decision that the liability of the cor-"porate trustee though acting as a fiduciary was limited by "the terms of the trust indenture" (R. 3705).

In short, the Trial Court predicated his release of CHASE NATIONAL, in holding, contrary to its concessions, that this National Bank was not a fiduciary. The Court of Appeals has sustained his result by holding that CHASE NATIONAL is a fiduciary; but that its fiduciary duties are only those expressly set forth in a contract. In other words, a National bank fiduciary may traffic in its trust, if the trust indenture either permits or does not forbid such conduct. Will this Court leave undisturbed so immoral a view?

(c) Petitioners' Federal rights were asserted and the federal questions here presented were squarely raised, upon the

[4]CHASE NATIONAL admitted: "A trustee under a corporate mortgage indenture is actually a trustee." "The fundamental duty and obligation of one undertaking to hold, for the protection of another, a security for a debt, is the preservation of that security" and "the rule of undivided loyalty is applicable to corporate trustees under mortgage indentures" (R. 3713).

application for re-argument in the Court of Appeals. These questions were presented by order to show cause issued by the Chief Judge (R. 3707-3723). CHASE NATIONAL submitted opposing papers (R. 3699-3705) to which we replied (R. 3694-3698). Upon these papers the Court of Appeals denied the motion on the "ground that it does not present either authority or reason for changing our decision" (R. 3705). The Federal questions were properly presented and the Court of Appeals actually entertained and decided them (cf. *Herndon* v. *Georgia,* 295 U. S. 441, 443).

(d) Prior to the affirmance by the Court of Appeals it was inconceivable that that Court, despite prior settled New York as well as universal law and traditional equity jurisprudence, and despite the concessions of CHASE NATIONAL, would countenance the concept of a non-fiduciary trustee[5]. Under such circumstances, there "is no doubt that "the federal claim was timely", since "the ruling of the state "court could not have been anticipated and a petition for "rehearing presented the first opportunity for raising it" (*Herndon* v. *Georgia,* 295 U. S. 441, 444; cf. *Missouri Ex Rel. Missouri Ins. Co.* v. *Gehner,* 281 U. S. 313; *Brinkerhoff-Faris Trust & Savings Co.* v. *Hill,* 281 U. S. 673; *Mahler* v. *Eby,* 264 U. S. 32; *Tidal Oil Co.* v. *Flanagan,* 263 U. S. 444; *Great Northern Ry. Co.* v. *Sunburst Oil & Refining Co.,* 287 U. S. 358; *American Surety Co.* v. *Baldwin,* 287 U. S. 156; *Fleming* v. *Fleming,* 264 U. S. 29; see also, *Whitney* v. *California,* 274 U. S. 357; *Home Insurance Co.* v. *Dick,* 281 U. S. 397; *Saunders* v. *Shaw,* 244 U. S. 317).

[5]The *Benton* case cited by the Court of Appeals (R. 3705) is wholly inapplicable to our own. No "inconsistent" trustee was remotely involved. The facts bear no resemblance to those here found. The result in the instant case should be contrasted with that earlier expressed by the same Court through its then Chief Judge, Cardozo, in *Meinhard* v. *Salmon* (249 N. Y. 458, 464): "A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions. Wendt v. Fischer, 243 N. Y. 439, 444, 154 N. E. 303. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court."

Questions Presented

1. Whether, under Federal law and policy, independent of any particular State's fiat (Judicial or Legislative) or private contract, a National Bank Federally licensed "to act as "trustee" "or in any other fiduciary capacity" (12 U. S.. C. A. 248 (k)) is charged with and subject to minimal fiduciary duties and disabilities.

2. Whether, under Federal law and policy, a National Bank acting under a trust indenture by power granted pursuant to the National Banking Act, is charged with and subjected to a Federal standard of minimal fiduciary duties and disabilities of "undivided loyalty" and "full disclosure" to the beneficiaries of the trust.

3. Whether, under Federal law and policy, a National Bank fiduciary trustee, which was expressly found by a State Court voluntarily to have assumed an "inconsistent" role, to have been "at least negligent", to have failed to act "as a reasonably careful person" and to have thereby "damaged" its *cestuis,* may, by any particular State's fiat (Judicial or Legislative) or by private contract be absolved from the burdens of explanation and justification.

4. Whether, under Federal law and policy, the standard of the minimal duties and disabilities of a National Bank acting as a "trustee" "or in any other fiduciary capacity" under the National Banking Act, is measured solely by such law and policy and cuts across and supersedes State law or policy.

5. Whether, when CHASE NATIONAL accepted the post of trustee for petitioners, its *cestuis,* it was by force of Federal law and policy bound to act as a fiduciary charged with and subjected to the minimal duties and disabilities flowing from any fiduciary obligation.

6. Whether the basic determination below, that CHASE NATIONAL acted in relation to petitioners, its *cestuis,* either as a non-fiduciary trustee, or as one which could by contract

limit its fiduciary obligations, is not incompatible and in conflict with paramount and controlling Federal law and policy.

7. Whether, since the National Banking Act constitutes "by itself a complete system for the establishment and gov-"ernment of National Banks", the determination below that CHASE NATIONAL is not charged with and subject to minimal fiduciary duties and disabilities, does not impair, impede and destroy the efficiency of such quasi-governmental agency to discharge the duties and obligations imposed upon it by Federal law and policy; frustrate its public purposes; nullify the command of the National Banking Act; and abrogate Federal safeguards for petitioners and the public.

8. Whether the determination below is so arbitrary and capricious a departure from previously settled New York law, as well as universal law and traditional equity jurisprudence, the concessions of CHASE NATIONAL, and the undisputed facts, as to violate a Federal right of petitioners and thereby unconstitutionally deprives them of their property without due process of law.

9. Whether, under Federal law and policy the New York State Courts were correct in deciding that the beneficiaries of a National Bank fiduciary trustee which had damaged them by a negligent substitution of the trust *res* at a time when it occupied a position adverse to them, must, in addition to proving that such trustee stood to profit and did profit from such substitution, also affirmatively establish the trustee's intent to profit.

10. Whether the New York Court of Appeals was correct in deciding when it denied petitioners' motion for reargument and amendment of the remittitur, that the liability of CHASE NATIONAL "though acting as a fiduciary was limited "by the terms of the trust agreement", despite applicable and controlling Federal law and policy.

Statutory and Constitutional Provisions Involved

The relevant portions of the National Banking Act, as amended, are set forth in the Appendix, *infra*, pages 39-40.

The relevant portions of the Constitution are set forth in the Appendix, *infra*, page 40.

Statement

The record in this case consists of seven volumes and a supplement. In the interest of brevity we shall set forth only the more material facts *expressly* found below, except in a few instances where we quote uncontradicted testimony of CHASE NATIONAL's own witnesses and from "the not always "cooperative lips and files of the trustee itself" (R. 3678). In no instance do we quote the highly credible testimony of our own witnesses. The Findings are infinitely stronger than the statements of fact made in the opinion. The record is yet stronger than the Findings.

The holders of NEP 5% "Secured" Gold Debentures seek the removal of CHASE NATIONAL as their trustee and to compel that National Bank either to return the securities removed from their trust on December 21, 1931, or to respond for the damages occasioned (R. 40-42)[6].

It was expressly found that CHASE NATIONAL, the trustee, was "guilty of, at least, negligence" (R. 138, 121, 122) when it "as creditor of the obligor, occupied a position inconsistent "with its role as trustee for the debenture holders" (R. 89, 97, 67) and benefitted by the substitution (R. 86-89, 83, 122, 118) which it "permitted" (R. 110, 124). It was further expressly found that the prospectus issued on the sale of the debentures named the valuable securities deposited with the trustee without mention of the power of substitution (R. 59-60).

Finding: "42. The plaintiffs and other debenture holders relied upon the experience, power, financial

[6]Should CHASE NATIONAL be directed to replace the securities removed from the trust, and fail to do so, the extent of the loss will be separately determined (R. 1742-1744)

acumen and integrity of the trustee CHASE NATIONAL to serve as a protection to them for their investment."

"43. By accepting the designation as 'Trustee' CHASE NATIONAL represented to plaintiffs that it would exercise its experience, power and financial acumen to protect the interests of debenture holders" (R. 61-62).

Despite such express findings, as well as many others to some of which we hereinafter refer, the Trial Court held that by virtue of its interpretation of certain exculpatory clauses contained in the indenture, CHASE NATIONAL was really no trustee and had no fiduciary duties or disabilities. He stated that he was "reluctantly constrained to conclude that the defendant has successfully exempted itself from liability in this sad picture of high finance" (R. 3677). The Trial Court ruled that the bondholder-cestuis were required affirmatively to prove CHASE NATIONAL'S bad faith and had failed to sustain the burden of proof he thus imposed on them (R. 3646, 3664).

"The obligor, NEP, was one of the major holding companies near the top of the Insull System and dominated the Insull Empire in the Eastern part of the United States. It owned substantially all the voting stock of National Public Service Corporation.[7] Above NEP was the Middle West Utilities Company, which, in turn, was controlled by two other corporations, viz.: Corporation Securities Company of Chicago and Insull Utilities Investments, Inc., which were, in turn, controlled by the Insull family."

"NPS was likewise a holding company, and did not itself operate any utilities. It had its own senior issues of stock and its own funded indebtedness and separate creditors. Below it there was a veritable maze of sub-holding and sub-sub-holding companies and operating companies which had senior issues of stock, funded indebtedness and other obligations" (R. 47).

"The management and directorship of the various holding companies were the same, so that, in effect, the Insulls dominated the entire system, transferring and shifting loans, collateral, debits and credits from one company to another virtually at will" (R. 48).

[7]Hereinafter called "NPS".

Our NEP debenture bonds were sold to the public (including many of petitioners) early in January, 1928 (R. 59-61, 2943, 2952). It was subsequent to these sales that the trust indenture here involved was prepared and executed (R. 59, 2927, 3404-3408). "This indenture was particularly vicious" (R. 3675)—"a voluminous document of over one hundred "printed pages. It provided for the substitution of securi-"ties held thereunder under certain conditions; but the "clauses permitting substitution were so astutely tucked "away that the average layman would have the greatest diffi-"culty in discovering them. Not only the average layman, "but seasoned financial experts like those who published "Moody's Manual overlooked the power of substitution, for "until the collapse of the system, Moody's Manual in describ-"ing these debentures and the security behind them, never "mentioned the possibility of substitution of collateral" (R. 58). "The debentures themselves did not mention any right "of substitution of collateral" (R. 59). "At least some of the "plaintiffs would not have purchased these debentures had "they been informed that the security could be substituted" (R. 61). "The Ohio Electric Power Company, Michigan "Electric Power Company and Penn Central Light & Power "Company were all operating companies and the common "stock of each of them, before the substitutions, was held by "NEP directly" (R. 48).

Long prior to the substitution CHASE NATIONAL, by successive mergers, acquired both Equitable Trust Company and Seaboard National Bank (R. 49, 62). One Makepeace, "a "vice-president of CHASE NATIONAL, was at the same time a "director of NEP and of NPS. He was also a member of "the Executive Committee of NPS. During all of the time "he was a member of these boards he had been successively "an officer of Seaboard National Bank, Equitable Trust Com-"pany and of CHASE NATIONAL, all of which banks succes-"sively merged. Whatever the bank with which Makepeace "was connected at any period of NEP'S history, that bank "was the principal bank of NEP. Makepeace was an offi-

"cer of CHASE NATIONAL, receiving in 1931 an annual salary "of $45,000. * * * Makepeace purported to represent the de- "fendant, CHASE NATIONAL'S interests where it was neces- "sary or advisable to do so while on these boards" (R. 63-64).

CHASE NATIONAL thus simultaneously acquired Makepeace and became our substituted trustee. The record abounds with illustrations of the strenuous, undignified efforts made by this National Bank to procure Insull business (R. 3067-3070, 3075), before utility values started crashing after August of 1931 (R. 3667). CHASE NATIONAL thus became "the largest single creditor of NEP" (R. 67), and a creditor of "Corporation Securities Company of Chicago, the ultimate stockholder of NEP" (R. 75). It made loans "to Martin "J. Insull, chairman of the board of NEP and NPS of "$2,000,000 and $2,500,000 * * * respectively" (R. 76); to "Hary Reid, President of NEP and NPS * * * in the sum "of $80,188.89" (R. 80); "to Reid and Insull jointly" for $550,000 (R. 81); to "Zeigler, Treasurer of NEP and NPS, "which * * * aggregated $276,000" (R. 82).

> "In dealing with loans made alike to the various companies and corporate officers in the Insull system, CHASE NATIONAL, for its own purposes, grouped all such loans together under the caption of 'Loans to Insull Group'. In all, the total loans made by CHASE NATIONAL to the Insull group were $12,520,000. The collateral for all of these loans was in greater part the securities of some part of the so-called Insull system" (R. 84).

There was specially prepared and sent to Wiggin (R. 2985) a list of the hundreds of different items of business transactions thus built up between CHASE NATIONAL and the "Insull "Group" (R. 2978-2997), including "commercial accounts", "checking accounts", "trust business" and "pay and charge "arrangement" (R. 2991).

Then followed what the Court described as the "financial "debacle", and "precipitous decline of utility earnings" (R. "121, 3667). "The decline in market value of the collateral

"securing the loans to Martin J. Insull, including the se-
"curities of Corporation Securities Company of Chicago and
"Insull Utility Investments, Inc., during the summer and fall
"of 1931 caused the defendant CHASE NATIONAL to make"
"from the summer of that year until December 16, 1931"
"repeated calls for additional collateral" "increasingly fre-
"quent" "almost a daily occurrence" "until about December
"16, 1931" "Insull furnished additional collateral comprising
"primarily stock of Insull Utilities Investments, Inc. and
"Corporation Securities Co. The attention of the Discount
"Committee" was "specifically drawn to the nature of the
"additional collateral" "CHASE NATIONAL was much con-
"cerned over the large proportions of stock of Insull Utility
"Investments, Inc. and Corporation Securities Co." "many of
"the responsible officers of CHASE NATIONAL took active and
"important parts in handling these loans. Among them"
"* * * "Wiggin, McCain", "McHugh", "Aldrich", "Sherrill
"Smith, Makepeace and Schmidlapp" (R. 77-78).

"On the date of the substitution, Martin J. Insull, the
"vice-president and executive director of NEP owed CHASE
"NATIONAL $3,916,000 which he could not pay and which was
"under-collateralized" "On or about December 16, 1931,
"shortly prior to the substitution" "Insull informed Aldrich"
"that he could no longer supply additional collateral or re-
"pay the loans" (R. 79).

"Ziegler" and "Reid" "were similarly indebted to CHASE
"NATIONAL in large amounts which they could not pay" (R.
"80). "CHASE NATIONAL was well aware that the soundness
"of the obligation of NEP Company was partially dependent
"upon the soundness of Middle West and of the Insulls"
"(R. 68).

With respect to CHASE NATIONAL'S own loans to NEP, the Court found: "In each instance CHASE NATIONAL required "full information and gave careful consideration to the mat-
"ter before acceding. In each instance CHASE NATIONAL re-
"ceived collateral of equal or greater value than that sur-
"rendered" (R. 71). "CHASE NATIONAL required the operat-

"ing company collateral because NEP, NPS and Seaboard "Public Service Company were holding companies" (R. 70-71).

On December 16, 1931, CHASE NATIONAL thus received for itself the "$3,160,000 note of Central Eastern Power Com-"pany", collateralized by the stock of Central Utilities Ser-"vice Co. and the note in like amount of Central Utilities "Service Co. and also secured by subordination agreements "of NEP and Central Utilities Service Co. This substitution "constituted Chase National the chief creditor of Central "Eastern" (R. 73-74).

It will be noted that December 16, 1931 was the same date when Martin Insull, in the picturesque language of CHASE NATIONAL'S counsel, stated that he was "scraping the bottom "of his box" and "pleaded for mercy" (R. 1787).

"The $6,000,000 loan by CHASE NATIONAL to NEP was "made to be repaid in the early Fall of 1931" but "in Sep-"tember 1931, NEP was not only unable to repay its loan "from CHASE NATIONAL but requested a further loan of "$1,000,000, which was not furnished" (R. 74). CHASE NA-TIONAL'S "Makepeace was informed of pending plans to pay "off bank loans" "and also for public financing by means of "Ohio Electric Power Company"[2] (R. 74) "Makepeace knew "the inconsistent position of CHASE NATIONAL as a creditor "of NEP and as a trustee for debenture holders of NEP." He "knew of the prospectus issued in conjunction with the "sale of debentures to the public, including these plaintiffs" (R. 97). "Makepeace knew and approved the proposal to "withdraw some of the operating company stocks from under "the indenture, at least some weeks before the substitu-"tion transpired" "and substitute the stocks of NPS." He

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[1]CHASE NATIONAL did not "accept" Central Eastern until Makepeace, Martin Insull, Reid and Zeigler (a majority of the NEP board) had first voted to withdraw Ohio Electric from CHASE NATIONAL as our trustee, and then to give that withdrawn trust *res* to Central Eastern, CHASE NATIONAL'S debtor (R. 3046-3047).

[2]The stock of Ohio Electric was then still pledged under our indenture (R. 61, 48, 60).

"knew that a campaign in November to sell (NPS) Class "B stock" "in order to raise funds had failed" (R. 98).

"The plans for the utilization of the securities withdrawn "from under NEP's indenture were discussed among the di- "rectors of NEP including Makepeace from time to time "prior to the actual withdrawal on December 21, 1931" (R. 124).

December 16, 1931 (five days before the substitution) besides witnessing Martin Insull's personal collapse *supra* and CHASE NATIONAL's receipt of the Central Eastern collateral to its own loans to NEP and NPS *supra*, was the occasion of a visit by Samuel Insull, Jr. and Harry Stuart with Aldrich at which time, "CHASE NATIONAL agreed to join with other "banks holding collateral of Corporation Securities Company "against loans, in an agreement tantamount to a 'standstill' "or moratorium for four[10] months" (R. 120), "CHASE NA- "TIONAL knew that the general financial situation was crit- "ical" (R. 118).

Two days later, "on December 18, 1931, NEP made appli- "cation to defendant, CHASE NATIONAL, as trustee, for the re- "lease of the stocks of 'Penn Central', 'Michigan Electric' "and 'Ohio Electric' and the substitution therefor of 276,522 "shares of the Class A common and 444,868 shares of the "Class B common stocks of NPS" (R. 109-110). "The appli- "cation was referred to" "Buckley", "assistant trust officer "of" "CHASE NATIONAL, who made no inquiry or investigation "as to the truth or falsity of the earnings certificate" "took "no steps to verify or have verified any of the matters of fact "recited" "testified he was ignorant of the affairs of NPS and "NEP" "neither had nor sought information with respect to "value of the securities involved" "had no balance sheets, or "profit and loss statements, and made no effort to obtain "them or to ascertain market prices" "consulted no other of- "ficer of" "CHASE NATIONAL" (R. 110). Buckley sent these papers "to counsel for the trustee for approval *as to matters "of legal form only*" (R. 113).

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[10]The bankruptcy preference period.

"Though the trustee had, and was aware of, the right[11] "to make an investigation at the expense of the obligor before "granting an application for substitution, it did not make "such an investigation. The trustee did not consult any of "the debenture holders, nor call a meeting of the latter, as "it had a right to do under the terms of the indenture, before "granting an application for substitution. Buckley had been "informed on November 12, 1931 that the debenture holders "were relying upon the security of the stocks of 'Penn Cen- "tral', 'Ohio Electric and Michigan Electric' for protection" (R. 117-118).

"The trustee did not advise the debenture holders at large, "or the general public, of the fact that it had permitted a "substitution of collateral" (R. 120).

"CHASE NATIONAL, by reason of the making of" (the) "standstill agreement," (of December 16, 1931) "if for no "other reason, knew that the top holding companies of the "Insull system were in precarious condition" (R. 120).

"CHASE NATIONAL knew the close connection and inter- "dependence financially between Corporation Securities Com- "pany and the other holding companies of the Insull system; "and it, of course, knew of the standstill agreement of Decem- "ber 16, 1931" (R. 121-122).

"In December, 1931, CHASE NATIONAL knew that the In- "sull situation was difficult and promptly acted to secure and "strengthen its loans to the Insull group. Every one of these "loans was immediately reviewed, counsel consulted, addi- "tional documents and commitments from the obligors called "for, and methods of liquidation and reduction of indebted- "ness taken up with the obligors." "CHASE NATIONAL con- "ceded at the trial that after the conferences with the In-

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[11]CHASE NATIONAL was under no duty to permit the substitution. The indenture provides that it "may in its discretion make any such independent inquiry or investigation as it may see fit." "it shall be entitled to examine the books and records of the Company, either itself or by agent or attorney; AND UNLESS SATISFIED, WITH OR WITHOUT SUCH EXAMINATION, OF THE TRUTH AND ACCURACY OF THE MATTERS STATED in such resolutions, certificate, statement, opinion, report or order, IT SHALL BE UNDER NO OBLIGATION TO GRANT THE APPLICATION" (R. 57-58).

"sulls on December 16, 1931, Aldrich and Sherrill Smith "would have been neglectful of their duties to CHASE NA-"TIONAL had they not immediately made full investigation of "the status of borrowers in the Insull group and taken active "steps to protect the bank. This they concededly did" (R. 122-123).

Just as concededly, they did nothing whatever for the beneficiaries of the trust which they were administering under representation that they would protect the debenture holders. "Aldrich and Sherrill Smith knew that CHASE NA-"TIONAL was trustee for debenture holders of NEP. At least "Aldrich was in charge of the trust department of CHASE NA-"TIONAL. He owed the same duty to the trust department as "he owed to the loan department of his bank" (R. 123). "The bank balances of NEP and NPS in CHASE NATIONAL "and other banks had severely declined" (R. 121). "CHASE "NATIONAL knew all of the facts and information actually ac-"quired and learned by Makepeace as a director of NEP and "NPS" (R. 100). "Makepeace knew the inconsistent position "of CHASE NATIONAL as a creditor of NEP and as a trustee "for debenture holders of NEP. Makepeace knew that NPS "earlier *on the very day of the substitution* had been reduced "to the necessity of borrowing on the life insurance policies "of its officers for the purpose of meeting year-end require-"ments" (R. 97).

Prior to the substitution of December 21, 1931, the "invest-"ment service department" of CHASE NATIONAL had given advice "to customers of the Bank with respect to securities of "NEP and NPS" (R. 89). "CHASE NATIONAL itself as shown "by its investment and credit files, criticized adversely the "earnings reports of NPS" (R. 91). This did not deter that National Bank from its pretended reliance on earnings certificates of the same company, in "permitting" the substitution. Months before the date of the substitution CHASE NATIONAL had written: "The company's tactics in this case, "however, is to charge engineering services of this type to "property account and show the result of such increased capi-"talization as actual income available for the payment of in-

"terest and dividends" (R. 91-92), "extreme remoteness" "from actual earning power", "relatively small equity in "tangible assets", "other uncertain factors", "a very specu- "lative type of security"—"hardly possible to make an ac- "curate computation of earnings", "derives a substantial "part of the gross revenues from the less stable forms of "utility service", "funded debt and capital stocks of sub- "sidiaries are outstanding in an amount almost five times "as large as gross operating revenues" "these shares in- "volve a considerable number of unsatisfactory features" (R. 92-93).

Not only had CHASE NATIONAL, itself, thus characterized NPS *common* stock long prior to the "financial debacle" and "precipitous decline in utility earnings"; but further wrote: "that the company's *preferred* stocks occupy a rather remote "position in relation to earnings" and that its bonds were of a "junior nature", "rather poor protection afforded "them by earnings", "occupy a speculative position and "must be regarded as undesirable for conservative invest- "ment purposes", (R. 94), and wrote of NEP, our obligor, that "increasing fixed charges have caused a downward "trend in the margin of protection", "the rather unim- "pressive earnings record of the company", "preceded by "more than $230,000,000 of subsidiary obligations", "de- "crease in the degree of protection accorded", and "specu- "lative" (R. 95).

Nevertheless it was the lowest, poorest and weakest of all these issues, viz.: the Class B (and some Class A) stock of NPS which CHASE NATIONAL, as our trustee, accepted in substitution for the stocks of good operating companies.

"All of the operating company stocks pledged under the "indenture securing the debenture holders of NEP were "withdrawn; and only holding company stocks were left "as security for the debenture holders of NEP. Con- "versely put, no holding company stock was withdrawn, "and no operating company stock remained after the sub- "stitution of December 21, 1931" (R. 124-125).

"The debenture holders of NEP were damaged by the sub-"stitution of securities permitted by CHASE NATIONAL as "trustee for the debenture holders on December 21, 1931" (R. 125).

> "293. *At the time of the substitution,* CHASE NATIONAL had received and placed in its credit files a reissued and revised prospectus offering for sale debentures of the issue held by the plaintiffs, which prospectus recited the security for the debentures as including the same shares of 'Penn Central', 'Ohio Electric' and 'Michigan Electric' mentioned in the earlier prospectus and *which prospectus still failed to mention any power of substitution"* (R. 122). (Emphasis ours.)

"The stock which CHASE NATIONAL permitted NEP to "withdraw was at the time of the withdrawal and at all "times thereafter, down to the present, concededly of sub-"stantial value" (R. 87-88).

When Makepeace and his fellow directors found NEP and NPS unable to perform their promise to repay CHASE NATIONAL, as far back as September 1931, they had before them the scheme to withdraw the sound operating company stocks and substitute the common stocks of NPS, the holding company which could not perform its promise to repay CHASE NATIONAL. CHASE NATIONAL'S own exhibit (W W., R. 3546-3547) reads: "The Trustee of NEP debentures to be peti-"tioned for the release of common stock of 'Penn Central' "and 'Ohio Electric' now pledged under the 5% Secured "Debentures. It may be necessary to pledge additional "assets of NEP in order to accomplish this, and for this "purpose we will have available common stocks of NPS." "NPS will purchase from NEP its interest in 'Penn Cen-"tral' and 'Ohio Electric.' Payment therefor to be made "through NPS Class A and Class B common stock." "Cen-"tral Eastern will then acquire from NPS its interest in "'Penn Central' and 'Ohio Electric'."

We have previously referred to the finding that "Make-"peace was informed of pending plans to pay off bank "loans, involving the sale and exchange of properties in

"Ohio * * * and also for public financing by means of 'Ohio "Electric'" (R. 74).

Reid, President of NEP, CHASE NATIONAL's main witness at the trial, was asked why the substitution of which we complain was made. He explained that NEP "had large "bank loans with a difficult situation of refunding these "loans into some form of permanent financing * * * be- "cause the market was not absorbing whatever securities "there might be to offer. * * * We got these stocks out so "that we could carry through these other transactions, and "in that way refund our obligations" (R. 2236). Only by CHASE NATIONAL, as trustee, yielding to its own personal debtor the securities held in trust, could "these bank loans be refunded."

We respectfully maintain that, in point of law, it is sheer euphemism to hold a trustee "guilty of, at least, negli- "gence" who satisfies the first mortgage it holds in trust for its *cestuis* and thereby makes its own second mortgage a first mortgage. NPS was indebted to CHASE NATIONAL. When our operating company stocks were surrendered to that holding company, and we were given its own Class B common stock, CHASE NATIONAL, creditor of NPS, immediately stood senior to the beneficiaries of its trust. The bondholders immediately lost their lien upon the operating properties. CHASE NATIONAL immediately gained a creditor's senior access to this new part of the general estate of its debtor. Our bondholders, however, could not possibly have access to these same assets until CHASE NATIONAL'S loans to the company, whose common stock they now held as security, had been paid in full.

Unfortunately for CHASE NATIONAL, the plan to repay its loans (R. 74, 2276) from the proceeds of public sales[12] of new securities to be issued against our surrendered *res* (R. 2236) was thwarted by the simple honesty of another indenture trustee,[13] with no interest adverse to its bene-

[12]"Halsey Stuart & Company were ready to commit themselves formally for at least a million dollars worth of these Penn Centrals" (R. 2280).

[13]"When the corporate trustee for Municipal debentures refused the necessary consent" (R. 109. cf. 3446-3453).

ficiaries, and no axe of its own to grind. To this extent the contemplated repayment of CHASE NATIONAL from the proceeds of securities released from our trust was blocked. This did not cure the injury already done CHASE NATIONAL'S *cestuis*. Their security was gone just as definitely as if this particular profit to CHASE NATIONAL from traffic in the trust *res* had not been prevented. Once the bondholders' lien on the stock of "Penn Central" was released, it became the free asset of the obligor which previously "had pledged practically every bit of free collateral" (R. 98). CHASE NATIONAL previously had "obtained the notes "and endorsements of subsidiaries of NEP and agreements" "whereby NEP subordinated its claims against important "subsidiaries" (R. 89).

"The bank balances of NEP and NPS in CHASE NA-"TIONAL and other banks had severely declined" (R. 121), and "the Insull situation was difficult" (R. 122). NPS "had been reduced to the necessity of borrowing on life "insurance policies" "for the purpose of meeting year-end "requirements" (R. 97). "Current liabilities of both NEP "and NPS far exceeded the current assets" (R. 98).

"When the corporate trustee for Municipal debentures re-"fused the necessary consent, the 'Penn Central' stock hav-"ing already been withdrawn was thereupon utilized to pro-"vide additional security for New York Trust Company and "to secure from that bank moneys necessary to meet January "1, 1932 financial obligations of the NEP system" (R. 109).

"The release of the securities from under the indenture "enabled NEP to borrow funds thereon sufficient to meet its "January 1, 1932 requirements" (R. 118).

"Of this sum $250,000 was paid to CHASE NATIONAL by "NEP for the payment of semi-annual interest due January "1, 1932, upon the (our) debentures" (R. 119).

Thereby NEP debenture holders received one-half year's matured interest on their debentures, and thereby they lost their entire principal. They were given an infinitesimal part of the proceeds of the *res* removed from their trust, and lulled into a sense of false security, until after the expira-

tion of the four months' moratorium made by their trustee with other banks, *before* "permitting" the substitution.

"CHASE NATIONAL would not have received their payment "February 27, 1932, if NEP had been in receivership on "January 1" (R. 88). "CHASE NATIONAL would not have "received the $500,000 paydown of March 31, 1932, had "NEP entered bankruptcy on January 1" (R. 88-89). "In "the early part of 1932 CHASE NATIONAL *caused* NEP to "assume the obligations to the former of Zeigler, an officer "of NEP, and to subject thereto the collateral under the "CHASE NATIONAL loans to NEP" (R. 83).

These indicate some of the many ways in which our trustee benefitted by the substitution. We shall show just a few of the many other examples with which this record abounds. The Trial Court, although his express findings show that CHASE NATIONAL *both stood to profit* and *did profit* from the substitution, held that it did not contrive or permit this substitution for those reasons (R. 117). A trustee must not be allowed to put itself in a position where this suspicion can even arise. Nevertheless the Trial Court put upon the bondholders the impossible burden of proving that the minds of this National Bank's officers were predominantly fraudulent. By holding it in no sense a fiduciary, he relieved it of the "burdens of explanation and justification". We respectfully ask this Court to bear in mind that his findings of the bank's innocence and good faith are not findings that the bank had explained and justified its conduct; but a Scotch verdict of "not proved guilty".

Not one word in this indenture, which the Trial Court termed "particularly vicious" (R. 3675) directly or indirectly permitted this trustee to take a position adverse to its beneficiaries, the bondholders. On the contrary, merely to allow the trustee to put itself on a position of parity with the bondholders, those who drafted the instrument went out of their way specifically to provide that the trustee might itself purchase or otherwise acquire the same NEP debentures. Section 14 of Article XV of the indenture reads: "The Trus-

"tee acting for itself or as a banker may become a pur-
"chaser, seller, distributor or pledgee of bonds and coupons
"secured hereby with the same rights that it would have if
"it were not Trustee and without liability or accountability
"to the company or the bondholders * * *."

The Trial Court reversed established canons of construction for trust instruments, by interpreting the terms of this indenture loosely in favor of the trustee and strictly against the *cestuis*. It was this construction which made the trust seem more illusory than genuine, despite the fact that the instrument gave the trustee title to the securities deposited, and a duty to use for the bondholders' benefit. In consequence, the Trial Court was preoccupied with the question of the trustee's intent to profit, as distinguished from the fact that it had voluntarily placed itself in an adverse position where it stood to (and in fact did) profit from the substitution.

It was gravely important to CHASE NATIONAL that no receivership of NEP transpire on January 1, 1932. We have already quoted the findings that CHASE NATIONAL's immense loans to Martin Insull and to other high officers of NEP and to Corporation Securities Company, were almost entirely secured by the paper stock of Insull Utilities Investments, Inc., Corporation Securities Company, and "Middle West." NEP was their subsidiary. Its receivership would obviously immediately have wiped out the market value of the collateral held by CHASE NATIONAL for those loans. "CHASE "NATIONAL knew" this "close connection and interdepend-"ence financially" (R. 122-123 cf. R. 68).

Equally important, receivership of NEP would have jeopardized CHASE NATIONAL's claim to the collateral to its loans to NEP and NPS because "CHASE NATIONAL required "among other things resolutions and properly executed sub-"ordination agreements from NEP and its subsidiaries to "further secure the loan to NEP. The general resolution of "NEP authorizing officers to borrow for NEP required the "signatures of two officers. Up to December 21, 1931, only

"one signature had been obtained. CHASE NATIONAL, after "January 1, 1932 required and obtained similar documents "signed by two officers and also dated as of June 13, 1931. "In similar fashion CHASE NATIONAL after January 1, 1932, "obtained from Central Utilities Service Co. an agreement "not to pledge signed by two officers and dated December 4, "1931, in place of one signed by one officer" (R. 86-87).

Without the substitution, there would have been year-end defaults and a receivership. The banks' private receivership, or moratorium agreement, would have been destroyed. The four months' bankruptcy preference period would not have expired. CHASE NATIONAL's shameless dating back (as of six months earlier) of collateral loan agreements could not have taken place, and CHASE NATIONAL might thus have been forced to become the same unsecured creditor of NEP that it had caused its *cestuis* to become, by the fact of the substitution.

We respectfully urge the reading of Findings 134 to 144 (R. 82-84). The opinion (R. 3678) refers to "the startling "conduct of Martin Insull and his colleagues in foisting the "personal under-collateralized loans of various officers of the "Insull system upon Electric Management and Engineering "Corporation, one of the subsidiaries of the system. NEP "and NPS owned this subsidiary." Findings 134 to 144 forcefully indicate how much stronger are the Trial Court's findings, than his published opinion. In this instance they show that it was not so much the conduct of Insull, Reid and Zeigler which was "startling"; as that of our own trustee. These loans were all loans due from said officers to CHASE NATIONAL, upon their own, purely personal, gambling accounts. These Findings further show that it was our trustee who *forced* these officers to have our obligor and its subsidiaries assume their obligations to CHASE NATIONAL. This is another direct instance where this adverse trustee used its position to benefit itself, at the expense of its *cestuis*.

To the same effect we here print, without comment, Finding 115:

"On September 16, 1931 CHASE NATIONAL secured a paydown of $233,495 on the $2,250,000 Martin J. Insull loan by releasing for sale to NEP of $348,500 face amount of the debentures of NPS then held by it as collateral to that loan. These bonds were sold to NEP, with the knowledge of CHASE NATIONAL, at a price of 72, five points above the market, the extra five points being given to Martin J. Insull personally" (R. 78).

Nevertheless, the Courts of New York have refused to use the term "bad faith", or even "gross negligence", by which to characterize the conduct of this important bank. *Quaere:* From the viewpoint of Federal law and policy, may National Banks find exculpation from such conduct?

Following the expiration of the moratorium agreement, first Middle West Utilities Company and then NEP[14] and NPS, went into receivership and bankruptcy. "The obligor "under the debentures, NEP, also became bankrupt in July "of 1932, following a voluntary receivership in June" (R. 88). "NPS went into bankruptcy, and its common stocks, "which had been deposited with CHASE NATIONAL in sub-"stitution for the stocks withdrawn, were then concededly "worthless" (R. 87). CHASE NATIONAL'S Makepeace testified that there was no substantial change in the assets, the value of the assets, or in the liabilities[15] of NPS between the date of the substitution and the date of the bankruptcy (R. 793-794) "The secured debentures of NPS "(senior to the Class A and Class B stock substituted, as "well as senior to the Preferred Stocks and debts, includ-"ing obligations on notes held by CHASE NATIONAL) were "selling at 36 cents on the dollar on the date of the sub-"stitution" (R. 121). Even that 36 cent quotation was fictitiously created by the "pegging operations" as to which

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[14]CHASE NATIONAL attempted to have one of its directors made receiver (R. 3278-3280).

[15]The memorandum estimate of CHASE NATIONAL'S Buckley reads: "* * * there were approximately $22,000,000 of claims and that at the present time the assets consist of cash aggregating about $103,000. Therefore, the probable distribution on claims allowed would be very small and, in no event, would exceed ¼ of 1% and certainly the stock would be worthless." (R. 3273.)

CHASE NATIONAL's witness, Reid, testified (R. 2203-2204). When CHASE NATIONAL, our trustee, participated in this hasty, week-end, transaction by which the entire portfolio of our trust was substituted "the knowledge of CHASE "NATIONAL on the date of the substitution is the sum total "of all of the actual knowledge and information which its "various officers themselves had, as officers, and also all the "material contained in the various credit and investment "files of the bank on that date. The defendant as trustee "comprises all of its officers, its board of directors and its "files. The actual knowledge acquired by Makepeace as a "director of NEP and NPS is to be attributed to defend-"ant, CHASE NATIONAL" (R. 137).

Despite such a record and despite such Findings, the New York Court could go no further than to conclude: "The facts known to CHASE NATIONAL would have deterred "a reasonably careful person from giving up the securities "of the three operating companies for those of more doubt-"ful value of the holding company. CHASE NATIONAL was "guilty of, at least, negligence in permitting the substitu-"tion" (R. 138).

Notwithstanding the restrictions in the trust indenture, the fact still remains that if CHASE NATIONAL had not made this substitution it would not have profited nor would its *cestuis* have lost their money. Neither a trustee, a stakeholder, nor a bystander should escape responsibility under such circumstances. The size of the bank, its reputation, and the high position of its officers involved, cannot change this simple rule of honesty, nor should they be excused by anything written or unwritten. Not alone did this trustee concededly violate the rule of "undivided loyalty"; it furthermore violated the duty of making "full disclosure".

We have shown that this National Bank trustee failed to disclose to its *cestuis* the circumstance of its own adverse interest. It failed to disclose the plan to substitute the trust *res*. It failed to disclose the application for substitution. It failed to notify the bondholders or to call a meet-

ing, as was its right. It failed to disclose that it had elected not to investigate before "permitting" this week-end substitution.

Even after the substitution had been made, it failed to reveal that fact to its *cestuis;* but left it for them to discover for themselves after the bankruptcy of the obligor (R. 61). It resisted all efforts of the Bondholders Protective Committee to ascertain the circumstances surrounding the substitution of December 21, 1931 and affecting its own adverse interests. It bitterly resisted the discovery and inspection proceedings instituted. Its entire attitude is epitomized by the testimony of its president, Aldrich: "I con-"sider this whole suit as an insult to me, if you want to "know the fact. I am not particularly interested in doing "anything in regard to it except what I am directed by the "Court to do" (R. 1490). This lack of candor not only towards its own *cestuis;* but to the court as well, impelled the Trial Court to comment upon the "not always coopera-"tive lips and files of the trustee itself" (R. 3678).

When a National Bank applies to and receives from the Federal Reserve System a special permit to act in a fiduciary capacity, its exercise of such right and privilege carries with it the fundamental duties, disabilities, and obligations springing from any fiduciary relationship.

"The National Banking Act constitutes 'by itself a complete system for the establishment and government of National Banks'." *Deitrick* v. *Greaney,* 309 U. S. 190, 194.

" 'National banks are instrumentalities of the Federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States. It follows that an attempt by a state to define their duties or control the conduct of their affairs is absolutely void, wherever such attempted exercise of authority expressly conflicts with the laws of the United States, and either frustrates the purpose of the national legislation or impairs the efficiency of these agencies of the Federal government to discharge the duties for the performance

of which they were enacted. These principles are axiomatic, and are sustained by the repeated adjudications of this court.'

"Our conclusions, upon principle and authority, are that Congress, having power to create a system of national banks, is the judge as to the extent of the powers which should be conferred upon such banks, and has the sole power to regulate and control the exercise of their operations" (*Easton* v. *Iowa*, 188 U. S. 220, 238).

(cf. our brief to the Court of Appeals (R. 3718-3723).)

National Banks do not *ipso facto* possess the right and privilege to act as trustees or in any other fiduciary capacity.[16] Prior to 1913 no National Bank could act in such capacity. Following the decision in *First Nat. Bank* v. *Fellows ex rel. Union Trust Co.*, 244 U. S. 416 and by "Act of "September 26, 1918" "amending Sec. 11 (k) of the Federal "Reserve Act, the Federal Reserve System was empowered "'to grant by special permit to national banks applying "therefor, when not in contravention of state or local law, "the right to act as trustee, executor, administrator, * * * "or in any other fiduciary capacity'". *Missouri ex rel. Burnes Nat. Bank* v. *Duncan*, 265 U. S. 17, 23.

The House Report which preceded the adoption of this amendment of 1918 contains the following significant language, showing that the Congress was mindful of the necessity of protecting the public, as well as the desirability of granting limited privileges to National banks:

"These provisions are intended to impose safeguards upon the exercise of these fiduciary powers by national banks". H. R. No. 479—65th Cong., 2d Sess.

It will be observed that among other protections to the public, regardless of what any lax state rule might permit,

[16]The Federal Reserve System regulations specifically provide: "In passing upon an application for permission to exercise the fiduciary powers authorized by Section 11 (k) of the Federal Reserve Act, as amended, the Board of Governors of the Federal Reserve System will give special consideration to the following matters:" (listing seven specific and one all comprehensive qualification) (Regulation F, Sec. 2).

National Banks acting as fiduciaries are specifically required to keep separate books of account and not to commingle trust funds with others. Under familiar canons of construction the words "or in any other fiduciary capacity" are patently words of limitation. They exclude the possibility of the creation of a non-fiduciary national bank trustee. Limitation to a fiduciary status is the statutory command.

There is no such creature as a non-fiduciary trustee or a non-fiduciary fiduciary. Any capacity which excludes the fundamental duties and disabilities of "undivided loyalty" and "full disclosure" is no fiduciary capacity at all. 3 *Bogert Trusts and Trustees,* Secs. 543, 544, 1935 Ed.; 2 *Scott Trusts,* Sec. 170 p. 856; Restatement of the Law of Trusts Sec. 2 (b), Sec. 170, Sec. 176 (cf. 3717-3718).

Where there has been a breach of these fundamental duties, it inexorably follows if a fiduciary be a fiduciary, that upon him be cast the "burden of justification and ex-"planation". The Trial Judge relieved this derelict trustee of liability because he found it was no fiduciary. He therefore placed the burden upon the beneficiaries to prove by a preponderance of the evidence that the trustee was actually motivated by bad faith. It is interesting to note that, four years after his decision in our case, Justice Rosenman wrote in *Blaustein* v. *Pan American Petroleum & Transport Co.* (174 N. Y. Misc. 601, 671.)

> "As was said in *Hazzard* v. *Chase National Bank* (159 Misc. 57, 83, 84; affd., 257 App. Div. 950; affd., 282 N. Y. 652): 'So strict is the rule of undivided loyalty to the beneficiary that the mere fact that a trustee has an interest inconsistent with the interest of his *cestui,* casts upon him the burdens of explanation and justification. (*Munson* v. *Syracuse, G. & C. R. R. Co.,* 103 N. Y. 58; *Globe Woolen Co.* v. *Utica Gas & Elec. Co.,* 224 id. 483.)'
>
> The case of *Irving Trust Co.* v. *Deutsch* (73 F. (2d) 121; certiorari denied, 294 U. S. 708) shows how high a standard of conduct equity has set for corporate fiduciaries. It also measures the weight of the burden of explanation which is placed upon the trustees."

Grave as are the facts found against CHASE NATIONAL, the record shows how much more rigorous those findings would have been had the Trial Court not so misplaced this all-important burden.

The decision of a State Court which suddenly transmutes the age old prohibition against the assumption by fiduciaries of interests adverse to their cestuis, constitutes in effect a license to such trustees to traffic in the trust res and thereby destroys without due process of law, the rights of beneficiaries to the time honored protection of the equitable arm of the Courts.

This question was directly presented to the Court of Appeals (R. 3723). It is obvious that the holders of these bonds purchased them in the belief that the trustee, supposedly protecting them, would never be allowed by any Court successfully to assume a position adverse to them. Every decision before and since that of the Courts below unalterably opposes such conduct on the part of any fiduciary. Only by holding that a trustee was not a fiduciary could the Trial Court relieve CHASE NATIONAL in the instant case. Only by holding that a trustee is that kind of fiduciary who may relieve himself from all the duties, obligations and disabilities of a fiduciary, could the New York Court of Appeals endeavor to sustain that result. In so doing, the fundamental property rights of our bondholders to a loyal and disclosing trustee were wiped out. There were simultaneously jeopardized, and perhaps in instances also erased, corresponding property rights of the holders of $54,000,000,000.00 in outstanding bonds. To produce this result, the New York State Courts consistently disregarded the written concessions made by the defendant before them, and failed to apply Federal law and policy. Such procedure, it is submitted, unconstitutionally deprived petitioners of their property without due process of law.

Specification of Errors

The New York Court of Appeals erred:

1. In holding that a National Bank trustee may by contract exculpate itself from the minimal fundamental duties, disabilities and responsibilities flowing from the fiduciary relationship, despite Federal law and policy.

2. In failing to hold despite Federal law and policy that a National Bank trustee once it accepts any trust is subjected to the minimal fundamental fiduciary duties of "undivided loyalty" and "full disclosure" to its *cestuis*.

3. In holding despite Federal law and policy that a National Bank trustee which it was decided had voluntarily assumed an "inconsistent" role; had been "guilty of, at least, negligence"; had not acted as "a reasonably careful person"; had made no "disclosure" and had thereby "damaged" its *cestuis;* was not charged by law with the "burdens of justification and explanation."

4. In failing to hold that the standard of the duties of CHASE NATIONAL when acting as a trustee under the National Banking Act is measured by Federal law.

5. In holding that the duties of a National Bank trustee to its *cestuis* may be abridged and restricted by contract thereby impairing, impeding and frustrating the public purposes and National policy of the National Banking Act.

6. In failing to hold that CHASE NATIONAL, a National Bank trustee, was subjected to the disabilities of a fiduciary, thereby nullifying the Federal safeguards and protection clearly intended under the National Banking Act for the protection and safeguard of petitioners and the investing public.

7. In holding despite Federal law and policy, that the duties and liabilities of a National Bank trustee can be limited and restricted solely and exclusively to the provisions of an agreement.

8. In holding that the liability of CHASE NATIONAL "though acting as a fiduciary was limited by the terms of the trust agreement", despite Federal law and policy.

9. In holding that CHASE NATIONAL was not subjected to the duties and liabilities of a fiduciary, and thereby, arbitrarily and capriciously, in violation of settled principles of law, contrary to the concessions of CHASE NATIONAL and the force of undisputed facts, violating a Federal right of petitioners and unconstitutionally depriving them of their property, without due process of law.

10. In affirming the judgments entered upon the decision of the Trial Court and of the Appellate Division of the Supreme Court of the State of New York for the First Judicial Department, dismissing petitioners' complaint and refusing to grant the relief prayed for in their complaint against CHASE NATIONAL.

Reasons for Granting the Writ

1. The New York State Courts have decided Federal questions of substance not theretofore determined by this Court (cf. Rule 38; 5(a) of Rules of this Court).

Again and again this Court has considered and defined the powers, rights, privileges and immunities of National Banks *but never their fiduciary duties, obligations or disabilities.* This case then is one of first impression involving the construction, application and interpretation of such duties and disabilities of a National Bank permitted under Federal law to act as a "trustee" "or in any other fiduciary capacity".

This Court has frequently considered cases concerning National banks. At its last term, for example, the following cases were decided: *Colorado National Bank* v. *Bedford,* 310 U. S. 41; *City of Yonkers* v. *Downey,* 309 U. S. 590; *Inland Waterways Corp.* v. *Young,* 309 U. S. 517; *Deitrick* v. *Greaney,* 309 U. S. 190. See, too: *Texas & P. R. Co.* v. *Pottorff,* 291 U. S. 245; *Marion* v. *Sneeden,* 291 U. S. 262; *Awotin* v. *Atlas Exch. Nat. Bank,* 295 U. S. 209. This Court has

squarely considered and determined the power of National banks to act as trustees, etc. *First Nat. Bank* v. *Fellows, ex rel. Union Trust Company,* 244 U. S. 416; *Missouri ex rel. Burnes Nat. Bank* v. *Duncan,* 265 U. S. 17; *Ex Parte Worcester County Nat. Bank,* 279 U. S. 347; but not, so far as diligent research discloses, the duties, obligations, liabilities and disabilities of National Bank fiduciary trustees.

The New York State Courts, however, have attempted such consideration, determination and definition.

2. This case has been decided by the New York State Courts in a way probably not in accord with applicable decisions of this Court (cf. Rule 38; 5(a)).

While we have not found a single decision of this Court which considered, determined and defined the duties and disabilities of a National Bank fiduciary trustee, there are obviously many applicable decisions of this Court concerning the duties and disabilities of those acting in fiduciary capacities.

Nearly a century ago, this Court determined that those who acted in a fiduciary capacity would be held to the highest fidelity.

> "The general rule stands upon our great moral obligation to refrain from placing ourselves in relations which ordinarily excite a conflict between self-interest and integrity * * *. It acts not on the possibility that, in some cases, the sense of that duty may prevail over the motives of self-interest, but it provides against the probability in many cases, and the danger in all cases, that the dictates of self-interest will exercise a predominant influence, and supersede that of duty." *Michoud* v. *Girod,* 4 How. 503, 555.

To the same effect: *Jackson* v. *Smith,* 254 U. S. 586; *Chicago M. & St. P. R. Co.* v. *Des Moines U. R. Co.,* 254 U. S. 196, 220; *Magruder* v. *Drury,* 235 U. S. 106, 119; *Geddes* v. *Anaconda Copper Mining Co.,* 254 U. S. 590, 599; *Pepper* v. *Litton,* 308 U. S. 295.

3. There is a direct conflict between the decisions of the New York State Courts and decisions of the Circuit Court of Appeals for the Second Circuit.

The State Courts have now expressly limited and restricted the duties of a mortgage trustee to the express words of the trust indenture. The said Circuit Court of Appeals on the contrary has determined that there are certain fundamental duties implied from the fiduciary relationship which cannot be obliterated by contract. *Miles* v. *Vivian*, 79 Fed. 848, 851; *Frishmuth* v. *Farmers' Loan & Trust Co.*, 107 Fed. 169. See also: *Kelly* v. *Central Hanover Bank & Trust Co.*, 11 F. Supp. 497, 509 (rev'd upon grounds immaterial here 85 F. (2d) 61).

4. There is a direct conflict between the Court of Appeals of the State of New York and the decisions of the highest Courts of other states.

The highest courts of states other than that of New York have expressly charged fiduciaries with implied fundamental duties which flow from the fiduciary relationship. *State* v. *Comer*, 176 Wash. 257; *Marshall & Ilsley Bank* v. *Guaranty Investment Co.*, 213 Wisc. 415; *Richardson* v. *Union Mortgage Co.*, 210 Ia. 346 (cf. opinion of Trial Court in this case R. 3669).

5. This case is one of vast public interest and importance.

(a) The petitioners herein are some 125 bondholders of NEP selected by their committee, and are residents of states throughout the Union. They include National and State banks.

(b) The interests of thousands of bondholders of NEP throughout the country will be directly affected by the result here attained.

(c) Most of the bondholders purchased their securities in interstate commerce and through the use of the mails.

6. The determination of the New York State Courts, if unchanged, destroys the public safeguards and protection clearly intended for the investing public by the National Banking Act.

Those New York Courts have squarely held that a National Bank trustee can contract away its fiduciary obligations. It has been recognized for generations that "sala-

"bility" of mortgage bonds to the public "depends in no in-"considerable degree upon the character of the persons who "are selected to manage the trust." (*Knapp* v. *Troy and Boston R. R. Co.*, 87 U. S. 117.) It was expressly found in our case that the bondholders "relied" upon CHASE NATIONAL and that it "represented" that "it would exercise its experience, "power, financial acumen" and "integrity" "to serve as a pro-"tection to them for their investment" (R. 61-62). Should the New York State Courts' determination be allowed to stand, National Bank trustees not only fail to protect the public, but in the language of the Trial Court may lend their quasi-governmental prestige to instruments which "have all "the potentialities of fraud upon innocent investors" (R. 3675). It is inconceivable to us that this Court will allow National Bank trustees to become active instrumentalities of fraud when public investors purchase securities upon the supposed protection afforded them by the National Banking Act and Federal agencies.

7. The importance of this case, at least in part, impelled Congress to enact the Trust Indenture Act of 1939 (the Barkley Act) (15 U. S. C. A. Sec. 77aaa, *et seq.*; Supp. 1939) (cf. frequent quotations of and references to the opinion of the Trial Court by the Securities & Exchange Commission, in Report VI "Trustees Under Indentures", issued June 18, 1936, and later report numbered VIII, issued September 30, 1940, p. 341, note 13). Very many texts, legal periodicals, and decisions considering trusts, and particularly those involving mortgage indenture trustees, have since 1936 referred to the opinion of the Trial Court.

While this Act may, in the future, prevent certain frauds and injustices to the investing public, by its terms it is inapplicable to existing indentures. The best available statistics indicate that upwards of $54,000,000,000.00 of the public's money is invested in corporate mortgage indenture bonds similar to that here involved. Such issues, totally unaffected by the Indenture Act of 1939, have a great many years yet to run—in some instances, more than fifty (R. 3714). In this case, the Trial Court pointed out that "this

"defendant, alone, at the time of the substitution was acting "as trustee under 850 similar indentures, totalling about "$5,000,000,000" (R. 3674). Billions of dollars of public money have been invested, in a great measure upon the supposed security afforded the investors by the National Banking Act and Federal agencies.

Many of these National Bank trustees are located in the State of New York. The investors who purchased the bonds, however, reside throughout the country and include both National and State banks. It is conceivable that each of the forty-eight States may by statute or decision set up its own standard of fiduciary obligation applicable to National Bank trustees. The rights and remedies then of each *cestui* may depend wholly upon the law and policy of that particular State in which suit is instituted. Unless the decision reached below is changed and this Court hold all National Bank Trustees, wherever located, to minimal Federal standards of fiduciary obligation, the practical result will be that each State, not the Congress or this Court, will be the final arbiter in its own jurisdiction to determine, construe, and define the duties and disabilities of National Bank fiduciary trustees.

Conclusion

Wherefore, it is respectfully submitted that this petition for a writ of certiorari should be granted.

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November 1940.

Appendix

Act of December 23, 1913, as amended, c. 6, Sec. 11, 38 Stat. 261; September 26, 1918, c. 177, Sec. 2, 40 Stat. 968; June 26, 1930, c. 612, 46 Stat. 814; August 23, 1935, c. 614, Secs. 203 (a), 342, 49 Stat. 704, 722; (12 U. S. C. A. 248 (k)) as pertinent provides:

The Board of Governors of the Federal Reserve System shall be authorized and empowered: * * *

Sec. (k) To grant by special permit to national banks applying therefor, when not in contravention of State or local law, the right to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the State in which the national bank is located.

Whenever the laws of such State authorize or permit the exercise of any or all of the foregoing powers by State banks, trust companies, or other corporations which compete with national banks, the granting to and the exercise of such powers by national banks shall not be deemed to be in contravention of State or local law within the meaning of this chapter.

National banks exercising any or all of the powers enumerated in this subsection (k) shall segregate all assets held in any fiduciary capacity from the general assets of the bank and shall keep a separate set of books and records showing in proper detail all transactions engaged in under authority of this subsection. The State banking authorities may have access to reports of examination made by the Comptroller of the Currency insofar as such reports relate to the trust department of such bank, but nothing in this chapter shall be construed as authorizing the State banking authorities to examine the books, records, and assets of such bank.

No national bank shall receive in its trust department deposits of current funds subject to check or the deposit of checks, drafts, bills of exchange, or other items for collection or exchange purposes. Funds deposited or held in trust by the bank awaiting investment shall be carried in a separate account and shall not be used by the bank in the conduct of its business unless it shall first set aside in the trust department United States bonds or other securities approved by the Board of Governors of the Federal Reserve System.

* * * * * * * * *

It shall be unlawful for any national banking association to lend any officer, director, or employee any funds, held in trust under the powers conferred by this section. Any officer, director, or employee making such loan or to whom such loan is made, may be fined not more than $5,000, or imprisoned not more than five years, or may be both fined and imprisoned, in the discretion of the court.

In passing upon applications for permission to exercise the powers enumerated in this subsection, the Board of Governors of the Federal Reserve System may take into consideration the amount of capital and surplus of the applying bank, whether or not such capital and surplus is sufficient under the circumstances of the case, the needs of the community to be served, and any other facts and circumstances that seem to it proper, and may grant or refuse the application accordingly: *Provided,* That no permit shall be issued to any national banking association having a capital and surplus less than the capital and surplus required by State law of State banks, trust companies, and corporations exercising such powers.

The Fourteenth Amendment to the Constitution as pertinent provides:

* * * nor shall any State deprive any person of life, liberty, or property, without due process of law; * * *

No. 557

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

IDA C. HAZZARD, ET AL.,

Petitioners,

v.

THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK,

Respondent.

PETITIONERS' REPLY BRIEF

JACK LEWIS KRAUS II,
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

IDA C. HAZZARD, ET AL., Petitioners, *v.* THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, Respondent.	No. 557

PETITIONERS' REPLY BRIEF

CHASE NATIONAL is an adjudicated tort-feasor, "guilty of, at least, negligence". After deliberately breaching its trust by voluntarily assuming a position antagonistic to its *cestuis*, it "permitted" a surrender of the trust *res*, which gravely damaged the beneficiaries. Such misconduct was strongly condemned below. Respondent's brief significantly omits mention of any of the foregoing findings and conclusions.

Both in spirit and in content, respondent's brief sharply poses the following problems in elementary honesty: May big scale wrong be perpetrated by a large institution with impunity, while lesser institutions or individuals are prohibited from acts similar in kind but smaller in degree? Did the framers of the Constitution of the United States and the Congress which enacted the National Banking Act intend that the Federal power and prestige of National Banks in fiduciary capacities should constitute a predatory sword in the hands of the interests wielding them, without both Constitution and Statute providing a Federal shield and protection to the investing public?

Respondent's lack of candor, which occasioned pointed judicial rebuke below, persists in its brief to this Court. Not once does that brief refer to the lengthy opinion of the

Trial Court (159 N. Y. Misc. 57; R. 3635-3678). Neither that opinion, nor the findings or conclusions, once state that this National Bank trustee was a fiduciary. That opinion employs the word "fiduciary" only to negate the idea of a status other than that of a "stakeholder". Only in denying the motion for re-argument, etc. did the New York Court of Appeals state "that the liability of the corporate trustee though acting as a fiduciary was limited by the terms of the trust agreement" (R. 3705). Respondent's assertions (Br. 14-15) that the Trial Court, the Appellate Division, and the Court of Appeals (prior to the motion for reargument, etc.) all held this National Bank "a fiduciary" is simply contrary to fact.

Respondent's colorable vehemence in treating our statements of fact studiously avoids reference to, and leaves totally unchallenged findings that this National Bank trustee:

a. deliberately assumed a position, after accepting the trust, definitely adverse to that of its *cestuis;*

b. elected to "permit" removal of the trust *res* pursuant to a concealed substitution clause, of which the *cestuis* were unaware;

c. represented to its *cestuis* the assumption of fiduciary duties, but secretly sought to evade them;

d. actively participated in the management and control of NEP, the obligor (and its personal debtor);

e. damaged the *cestuis* in "permitting" a substitution whereby at least NEP defrauded them;

f. "permitted" the substitution in asserted reliance upon an earnings certificate which it, itself, had previously, in writing, termed spurious;

g. deliberately refrained from exercising powers of examination expressly provided by the trust instrument, before "permitting" substitution, and surrendering the trust *res;*

h. failed to consult the *cestuis* before "permitting" substitution, and concealed the fact of substitution and of its own adverse interest.

The heat of respondent's references to collateral questions, leaves wholly undisputed the foregoing foundations for the invocation of controlling Federal law and policy. Respondent's complete avoidance of all mention of its breaches of trust, is almost surprising. However, since respondent has seen fit to put our veracity in issue, we add:

1. It is perfectly true, as respondent so frequently reiterates that the Trial Court "found" that this National Bank was not "actuated in any way by bad faith." We expressly (Pet. 24), directed the attention of this Court to the Findings (R. 117) so aggressively asserted by respondent, stating: "The Trial Court * * * held that it did not contrive or permit this substitution for those reasons (R. 117)." Findings such as 263, 264, 265 (R. 117) and 312 (R. 126) are legal conclusions rather than findings of fact. We recognize patent inconsistencies between such general conclusions and the specific findings of particular facts hereinafter enumerated. Our exception in point of law to these factually unsupported conclusions and the Trial Court's written reasons for reaching them, constitute one of the causes why we seek relief in this Court.

The simple fact remains that *every single line* of the petition, where quotation marks appear, is taken from the findings or opinion of the Trial Court, except as *specifically* noted. Nowhere does the petition state that the Judge, in express words, brought himself to say that CHASE NATIONAL profited by "permitting" the substitution. Instead, we specifically enumerated finding after finding where the Trial Court showed benefits accruing to CHASE NATIONAL after the substitution, which it would not have received, but for the substitution. Brevity bars setting these findings forth *in extenso*, but we respectfully request the Court's particular attention to the following findings in Volume 1 of the record:

151, 152, 153, 154, 155, 156, 157 (R. 86); 158, 159, 160 (R. 87); 165, 169 (R. 88); 135, 136, 137 (R. 82); 137A, 138, 139, 140, 141 (R. 83); 142, 143, 144 (R. 84).

Our petition showed the plans known to CHASE NATIONAL whereby NPS proposed to use the securities when released by our trustee from the lien protecting its *cestuis* (16-17, 21). We likewise showed how the simple honesty of the indenture trustee for Municipal Service bondholders, spoiled these plans (Pet. 22-23). The *subsequent* pledge of this released collateral with the co-defendant banks, in no wise altered the damage already done. One isolated finding that CHASE NATIONAL made no profit from the subsequent *pledge* to these other banks of the released collateral, is astutely confused by respondent with assertions that the Court thus found it had derived no profit from the *earlier substitution*, itself. The conclusion contained in Finding 312 related solely to the issue before the Trial Court with respect to the alleged conspiracy among the three banks. The language of 312 appears nowhere among the printed findings proposed by CHASE NATIONAL (R. 223-278); but is taken from the unprinted findings (cf. Note R. 278) "since no appeal has been taken with respect to the defendants the New York Trust Company and Manufacturers Trust Company". The substitution occurred December 21. The Penn Central Stock was pledged with New York Trust Company on December 30 and the Michigan stock with the same bank on December 26 (R. 125). This is far different from respondent's oft-repeated, bald assertion of: "The Trial Court's findings that respondent * * * did not profit (Finding 312; R. 126) * * * by the *substitution*" (Br. 12). In similar fashion, respondent quoted a portion of Finding 312 reading "did not profit directly or indirectly" (Br. 11, 14), without on those occasions adding the highly significant language of the remainder of the same sentence in the same finding "from the *pledge* of the collateral released from under the trust indenture with defendants New York Trust Company and Manufacturers Trust Company."

2. Respondent similarly relies (Br. 5-6) on findings 239 (R. 111) and 264 (R. 117) that the earnings certificate presented to it at the time of the substitution "correctly reflected the figures appearing on the books and records of NPS" and that "CHASE NATIONAL acted in good faith in relying upon the application papers". The simple fact is that CHASE NATIONAL *knew* that the "figures", "books" and "records" of NPS were false, and had so stated repeatedly in writing (Findings 177, et seq., R. 91-96).[1]

3. Respondent seeks refuge in the circumstance that Equitable Trust Company executed the original trust indenture (Br. 2, 4, 22). Equitable Trust Company had no position adverse to the bondholders. It had no officer on the board of the obligor. It had no loans to the obligor. It had no loans to the officers of the obligor. It had no loans to the parent company, the ultimate stockholder of the obligor. It was nearly 19 months *before* the substitution that CHASE NATIONAL became our substituted trustee by consolidation with Equitable Trust Company (R. 46).[2] It was after the consolidation with Equitable Trust that CHASE NATIONAL voluntarily loaned money to NEP (R. 67), with the endorsement of NPS (R. 69), to the Corporation Securities Company (R. 74-75), etc. The reissued original prospectus in the file of CHASE NATIONAL on the date of the substitution, represented that CHASE NATIONAL, not Equitable, was our trustee, and still failed to disclose the possibility of substitution (R. 122; Exh. 189, R. 3215-3218).

4. CHASE NATIONAL asserts that the indenture "entitled NEP" and *"required* the trustee" to make the substitution (Br. 3). This is simply contrary to fact. *Substitution was not mandatory* (cf. Pet. 18; R. 57-58).

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[1]Were we to adopt respondent's negative technique of quoting refusals to find, we would call attention to the highly significant modifications made in the defendant's proposed finding 129 (R. 266).

[2]The Court expressly found:

"43. By accepting the designation as 'Trustee' the CHASE NATIONAL represented to plaintiffs that it would exercise its experience, power and financial acumen to protect the interests of debenture holders" (R. 62).

5. The statement (Br. 13) that CHASE NATIONAL's loan to NEP was "amply margined" utterly ignores the legally invalid title shown by Findings 154-159 (R. 86-87), and that National Bank's efforts subsequently to switch other undersecured "Insull Group" loans to the greater safety of that revivified collateral (Findings 124-146) (R. 80-84).

Respondent's desperation is indicated by its use of the refusal to make certain findings (cf. Refusal 109, Br. 13), while failing to call this Court's attention to the alternative Finding 195 actually made (R. 98).

* * * *

Respondent flatly asserts (Br. 9) that we have conceded that the Federal questions were "raised for the first time on the motion to reargue", when, it alleges, we urged "some *undesignated* controlling Federal law", etc. The inaccuracy of such assertions will be evident from a reading of the supplement to the record (R. 3707-3723; 3699-3705; 3694-3698, 3705). There we expressly stated, in replying to an identical argument (R. 3700): "We do not concede that these Federal questions have not been present throughout this litigation; but maintain that no earlier occasion existed, for specifically arguing their effect" (R. 3695-3696). To preclude the possibility of respondent seeking the very pretext it now asserts, we then further explicitly pointed out to the Court of Appeals: "In the interest of justice, we respectfully pray that this Court, whether or not it feels that a Federal question was previously raised, or arose from an unanticipated ruling of the Court, nevertheless now entertain and decide the question presented" (R. 3697). Instead of offering the Court of Appeals "undesignated controlling Federal law", we specifically urged the self-same proposition, the self-same constitutional and statutory grounds, almost identically the self-same Federal decisions. Thus, when the Court of Appeals wrote that petitioners' papers on reargument did "not present either

authority or reason for changing our decision", the said Court necessarily entertained and decided the self-same Federal and constitutional questions we raise in this Court. The New York Court of Appeals thus held that the statutes of the United States, the Constitution of the United States, and the decisions of the United States Supreme Court, then, as now, urged by us, presented neither "authority or reason" for changing its decision that a National Bank fiduciary may successfully exculpate itself by contract from *all* fiduciary duties. We completely reject respondent's characterization of the papers before the Court of Appeals. We are confident that a reading of those papers set forth in the supplement to the record will furnish this Court with full and complete answers.

The jurisdiction of this Court is clear (Pet. 3-8). It is also clear that respondent has not answered the reasons for granting the writ set forth in the petition (34-38).

It is respectfully submitted that the petition for a writ of certiorari should be granted.

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No.: 557

IN THE

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IDA C. HAZZARD, *et al.*,

Petitioners,

against

THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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OCTOBER TERM, 1940

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Petitioners,

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THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

Statement.

This action was brought by petitioners in the Supreme Court of the State of New York "on behalf of themselves and of all other holders" of debentures of National Electric Power Company,[1] against The Chase National Bank of the City of New York,[2] The New York Trust Company and the Manufacturers Trust Company.

The gist of the complaint is that respondent, trustee of the trust indenture covering the issue of debentures, permitted withdrawal of securities so that such securities could be pledged with The New York Trust Company and the Manufacturers Trust Company for alleged loans to be used, in part, to pay indebtedness owing by NEP to respondent. The relief asked is that respondent be removed

[1] Herein called NEP.

[2] Herein called respondent.

as trustee; that The New York Trust Company and the Manufacturers Trust Company be compelled to account, and that respondent be compelled to account and to respond in damages.

The action was tried before Mr. Justice ROSENMAN without a jury. The trial lasted more than six weeks and there were upwards of 3300 pages of testimony and more than 500 exhibits (R. 3644). The Trial Court dismissed the complaint on the merits as to The New York Trust Company and the Manufacturers Trust Company at the close of petitioners' case and as to respondent at the end of the whole case and passed upon 316 proposed findings of fact submitted by petitioners (R. 144-217) and 168 proposed findings of fact submitted by respondent (R. 223-273). Those findings and the refusals to find cover every phase of the evidence, oral and written, and furnish a complete answer to every contention of petitioners.

The complaint alleges that The Equitable Trust Company of New York, a banking corporation organized and existing under the laws of the State of New York (R. 31), became the trustee of an indenture of trust in 1928 (R. 31); that thereafter The Equitable Trust Company of New York was consolidated with respondent and "for a valuable consideration assumed all of the duties, obligations and liabilities of said The Equitable Trust Company of New York with respect to the performance and discharge of the duties of the trustee as, in, under and by the said trust indenture embodied and set forth" (R. 34, 35). The Trial Court so found (Findings 2, 15 and 18; R. 46, 48, 49).

The trust indenture was prepared by the investment bankers who made the public offering of the debentures and by the attorneys for NEP (Finding 17; R. 49), and in its final form was brought to The Equitable Trust Company

of New York, which was asked and consented to act as trustee.

The trust indenture, printed in uniform type and indexed, apprised the debenture holders not only of the terms and conditions on which the security was deposited, but also of the rights of the debenture holders, the rights reserved by NEP and the duties assumed by the trustee. Moreover, each of the debentures referred to the trust indenture for a "description of the property pledged, the nature and extent of the security, the rights of the holders of the debentures as to such security, and the terms and conditions upon which the debentures may be issued and are secured." (Ptfs.' Ex. 1; R. 2927.)

The trust indenture provides that the security deposited with the trustee shall be held subject to and in accordance with the provisions of the trust indenture (Finding 20; R. 49, 50). The trust indenture entitled NEP to withdraw and required the trustee to deliver to NEP any securities on deposit with the trustee upon NEP's written application provided that, as shown by an earnings certificate, the amount of earnings applicable to debenture interest for a specific twelve months' period* from the securities remaining on deposit and from the securities deposited simultaneously with such withdrawal, were at least equivalent to twice the annual interest requirements upon all debentures then outstanding (Finding 20; R. 50, 51). There are other provisions in the trust indenture having to do with the formalities and the machinery of substitution (Finding 20; R. 51, 52).

The trust indenture specifies the terms and conditions upon which the trustee accepted the trust (Finding 23; R. 55).

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* "For a period of twelve consecutive calendar months within the fifteen calendar months immediately preceding the date of the application for such withdrawal or release." (Article IX, Section 5.)

Section 20 of Article XV of the trust indenture provides, as far as here material, that "any * * * bank into which the trustee * * * may be consolidated * * * shall be successor trustee under this indenture without the execution or filing of any paper or any further act on the part of either of the parties hereto, * * * provided such successor trustee shall be a corporation organized under the laws of the State of New York, or a national banking association, and shall have an office for the transaction of its business in the Borough of Manhattan, City of New York (Ptfs.' Ex. 1, pp. 93-94; R. 2927). The Equitable Trust Company of New York was consolidated with respondent on May 31, 1930 (Finding 2; R. 46) and the latter thereupon became the successor trustee under the indenture of trust (Finding 16; R. 49).

The only trust relationship between NEP, respondent and the debenture holders came into being through the trust indenture executed by The Equitable Trust Company of New York. That trust indenture is the only document to which respondent, as successor trustee, became a party. That is the document which fixed the rights of NEP and the debenture holders, and the duties of respondent as successor trustee.

In December, 1931, NEP made application to respondent under Section 5, Article IX of the trust indenture, for withdrawal from under the trust indenture of a portion of the collateral on deposit and for the substitution of other collateral (Finding 234; R. 109, 110). The application, accompanied by an earnings certificate conforming to the requirements of the trust indenture (Finding 235, R. 110), was referred to an officer of respondent of many years' experience (R. 2849, 2850) in the trust department (Finding 236; R. 110). The trust officer checked the application with the provisions of the trust indenture (Finding

245; R. 113), checked the computations in the earnings certificate (R. 396) and then referred the application to counsel (Finding 245; R. 113). Counsel examined the application and the pertinent provisions of the trust indenture; later conferred with counsel for NEP with reference to suggested changes, and on December 21, 1931, the application was approved and the substitution was made (Finding 246; R. 113).

The application, including the earnings certificate, was prepared in accordance with the provisions of the trust indenture (Finding 238; R. 110). The earnings certificate correctly reflected the figures appearing on the books and records of the corporation whose securities were substituted (Finding 239; R. 111) and showed that the earnings applicable to debenture interest for the twelve months ending October 31, 1931, on the securities which remained on deposit and the securities received in substitution were $1,603,793.81 (Finding 241; R. 111). This was not only twice but more than three times the $500,000 interest requirements for one year upon all outstanding debentures (Ptfs.' Ex. 13; R. 2976).

The Trial Court not only found that respondent, as substituted trustee, was authorized by the specific provisions of the trust indenture to rely on the earnings certificate as conclusive evidence of the facts therein stated (Finding 255; R. 115), but also found that an investigation of the books and records of the corporation whose securities were substituted would have disclosed that the earnings certificate was correctly taken from such books and records (Finding 256; R. 115). Further pertinent findings of the Trial Court follow:

> "260. The trust indenture expressly permitted withdrawal and substitution of collateral from under

it on the terms and conditions specified therein." (R. 116)

"238. The application papers, including the earnings certificate, were prepared in accordance with the terms and provisions of the trust indenture." (R. 110)

"239. The earnings certificate, in determining the earnings applicable to debenture interest in accordance with the provisions of the trust indenture, correctly reflected the figures appearing on the books and records of National Public Service Corporation and its subsidiaries." (R. 111)

"264. Defendant The Chase National Bank acted in good faith in relying upon the application papers for the release and substitution of collateral under the indenture and in permitting the substitution of the collateral thereunder." (R. 117)

"265. Defendant The Chase National Bank met every requirement of the trust indenture at the time of the substitution and release of collateral thereunder." (R. 117)

"263. Defendant The Chase National Bank did not permit the release and substitution of collateral under the trust indenture in order to obtain profit for itself at the expense of debenture holders, nor was it actuated in any way by bad faith." (R. 117)

"312. Defendant The Chase National Bank did not profit directly or indirectly from the pledge of the collateral released from under the trust indenture with defendants New York Trust Company and Manufacturers Trust Company." (R. 126)

Petitioners requested the Trial Court to find that respondent "stood to profit", "profited", "expected to benefit", and "benefited" by the substitution. All of these requests to find were refused. The Trial Court refused to find that:

"257. Aside from their obligations under trust indentures as corporate trustees, all of the banks, including Chase National Bank, stood to profit by the substitution made by National Electric Power Company of National Public Service Corporation stock in place of the stock of Penn Central Light and Power Company, Ohio Electric Power Company and Michigan Electric Power Company under the indenture securing the plaintiffs. *Refused.*" (R. 213)

"258. Each of the defendants in this case did in point of fact profit by virtue of the substitution made. *Refused.*" (R. 213)

"268. The Chase National Bank expected to benefit itself from the substitution under the indenture securing the National Electric Power Company debenture holders. *Refused.*" (R. 216)

"256. Chase National Bank benefited by the substitution, which enabled National Electric Power Company to use a collateral theretofore securing debenture holders, to raise funds to prevent open defaults and thus keep National Electric Power Company going for another six months. *Refused.*" (R. 212-213)

The Trial Court did find that:

"303. Defendant The Chase National Bank did not permit the release and substitution of the collateral under the trust indenture for the purpose of making the released collateral available for pledge with defendant New York Trust Company or defendant Manufacturers Trust Company." (R. 124)

"304. Defendant The Chase National Bank did not learn of the pledge of the collateral released from under the trust indenture with defendants New York Trust Company and Manufacturers Trust Company until after the commencement of this action." (R. 124)

"316. Defendant The Chase National Bank did not conspire with defendants New York Trust Company and Manufacturers Trust Company or either of them to bring about a release of collateral from under the trust indenture on December 21, 1931, or at any other time." (R. 126)

"317. Defendant The Chase National Bank did not conspire with National Electric Power Company and National Public Service Corporation or either of them or any of their officers or directors to bring about a release of collateral pledged under the trust indenture." (R. 126-127)

"318. Defendant The Chase National Bank acted in entire good faith as trustee under the trust indenture of National Electric Power Company and fully complied with all of the provisions and requirements of the trust indenture." (R. 127)

"319. Defendant The Chase National Bank acted in entire good faith as trustee under the indenture of National Electric Power Company in all dealings with debenture holders." (R. 127)

The Trial Court also found that:

"95. At all times hereinafter mentioned the collateral securing the $6,000,000 demand loan made to National Electric Power Company on June 19, 1931, by defendant The Chase National Bank had a market value in excess of the face amount of the loan and the loan was at all times amply margined." (R. 74)

"150. None of the loans made by defendant The Chase National Bank to National Electric Power Company, Corporation Securities Company of Chicago, Martin J. Insull, Harry Reid, Martin J. Insull and Harry Reid, jointly, and Charles B. Zeigler was connected directly or indirectly with the substitution of collateral made under the trust indenture on December 21, 1931, hereinafter referred to." (R. 85)

On June 28, 1938, the Appellate Division of the Supreme Court, State of New York, First Judicial Department, unanimously affirmed, without opinion, the judgment of the Trial Court (257 N. Y. App. Div. 950; R. 3684, 3685).

On March 5, 1940, the Court of Appeals of the State of New York affirmed, without opinion, the judgment of the Appellate Division (282 N. Y. 652; R. 3690, 3691).

On May 23, 1940, petitioners moved to reargue and to amend the remittitur (R. 3707, 3708).

On June 11, 1940, both the motion to reargue and the motion to amend the remittitur were denied (283 N. Y. 132; R. 3705).

Concededly the alleged Federal question was raised for the first time on the motion to reargue (R. 3712, 3713; Petition, p. 5). It was then urged that some undesignated controlling Federal law distinguishing between the duties and liabilities of a state bank acting as trustee under a corporate trust indenture, and the duties and liabilities of a national bank acting under the identical instrument had been overlooked (R. 3709, 3710).

Petitioners moved for leave to reargue and to amend the remittitur in the following language:

> "1—that reargument be allowed, and thereupon the judgments below be reversed, or, at least, that the cause be remitted to the Trial Court for additional or revised findings;
>
> "2—that should reargument be granted but the Court adhere to its original decision, then that this Court indicate, in the amended remittitur, that a Federal question or claim herein was presented, considered and passed upon;
>
> "3—that should reargument be denied, in any event, that the Court amend the remittitur and indicate there-

in that a Federal question or claim herein was presented, considered, and passed upon;" (R. 3707, 3708)

The Court of Appeals denied the motion for reargument and the motion to amend the remittitur saying:

"Ordered, that the said motion for reargument be and the same hereby is denied with ten dollars costs and necessary printing disbursements on the ground that it does not present either authority or reason for changing our decision that the liability of the corporate trustee though acting as a fiduciary was limited by the terms of the trust agreement (Benton *v.* Safe Deposit Bank of Pottsville, 255 N. Y. 260). Motion to amend remittitur denied." (R. 3705)

Petitioners quote portions of the opinion in inverted order and thus make it appear that the Court of Appeals considered and passed upon the alleged Federal question (Petition, p. 5). The language of the opinion shows the contrary.

* * * * *

We deem it important to point out some of the more glaring inaccuracies and distorted recitals of facts appearing in petitioners' "Statement" (Petition, pp. 11-20).

Although petitioners' "Statement" purports to be based upon facts "expressly found below", except for instances of "uncontradicted testimony" (Petition, p. 11), the "Statement" is interspersed with a highly colored, distorted, argumentative recitation of half-truths and, in some instances, of untruths. Petitioners state that respondent "benefitted by the substitution" (Petition, p. 11), that the Trial Court's "express findings show that Chase National both stood to profit and did profit from the substitution" (Petition, p. 24), that respondent "voluntarily placed itself in an adverse position where it stood to (and in fact did)

profit from the substitution" (Petition, p. 25), and that "if Chase National had not made this substitution it would not have profited" (Petition, p. 28).

The Trial Court found the exact opposite of each and every above quoted statement. It found that respondent "did not profit directly or indirectly" (Finding 312, R. 126). The Trial Court expressly refused to find that respondent "did in point of fact profit" (Refusal 258; R. 213) or that respondent "stood to profit by the substitution" (Refusal 257; R. 213). The Trial Court further refused to find that respondent "expected to benefit" (Refusal 268; R. 216) or that respondent "benefitted" from the substitution (Refusal 256; R. 212-213). This finding and these refusals to find have been quoted in full at pages 6 and 7 of this Statement.

Petitioners state that the "Trial Court ruled that the bondholder-cestuis were required affirmatively to prove Chase National's bad faith and had failed to sustain the burden of proof he thus imposed on them" (Petition, p. 12), that the Trial Court "put upon the bondholders the impossible burden of proving that the minds of this National Bank's officers were predominantly fraudulent" (Petition, p. 24), that the Trial Court "placed the burden upon the beneficiaries to prove by a preponderance of the evidence that the trustee was actually motivated by bad faith" (Petition, p. 31), and that the Trial Court "misplaced this all-important burden" (Petition, p. 32).

Each quoted statement in the preceding paragraph also is contrary to the fact. The Trial Court reserved decision on respondent's motion to dismiss at the close of plaintiffs' case and ruled that it wanted to hear the defense (R. 1828). Respondent then went forward with its proof. After full consideration of all of the facts and circumstances and all of the evidence, oral and written, the Trial

Court dismissed the complaint on the merits (R. 141). Thus it is evident from the record that the Trial Court based its findings, refusals to find and conclusions on all of the evidence. The Trial Court's findings that respondent met all the requirements of the trust indenture (Finding 265; R. 117), was not actuated in any way by bad faith (Finding 263; R. 117), acted in entire good faith (Finding 264; R. 117) and did not profit (Finding 312; R. 126) or intend to profit (Finding 263; R. 117) by the substitution were not, as petitioners suggest (Petition, p. 24), a Scotch verdict of "not proved guilty". Those findings were made upon all of the facts and circumstances and evidence, including that adduced by respondent.

The findings which the Trial Court made with respect to respondent should be compared by this Court with the findings which the Trial Court made with respect to The New York Trust Company and Manufacturers Trust Company (Findings 310-311; R. 125-126). The Trial Court dismissed the complaint with respect to The New York Trust Company and Manufacturers Trust Company at the close of plaintiffs' case and found that "there is no proof" that they did not act in entire good faith. The Trial Court dismissed the complaint with respect to respondent only at the close of the entire case and found not that there was a lack of proof, but that on all of the proof adduced respondent had "acted in entire good faith" (Finding 318; R. 127).

Petitioners repeatedly state and suggest that it was necessary for respondent to permit the substitution to protect its own position and to save its own loans. They state that "Only by Chase National, as trustee, yielding to its own personal debtor the securities held in trust could 'these bank loans be refunded' "; that respondent "immediately stood senior to the beneficiaries of its trust" and "gained a creditor's senior access" to the securities

released which became a "new part of the general estate of its debtor" (Petition, p. 22). These statements are in direct conflict with the Trial Court's findings.

The Trial Court found that the loan which NEP had with respondent was at all times amply margined (Finding 95; R. 74) and that none of the loans made by respondent was connected directly or indirectly with the substitution of collateral (Finding 150; R. 85). Moreover, the Trial Court refused to find that neither NEP nor any of its subsidiaries possessed on the date of substitution credit or collateral available for bank loans (Refusal 109; R. 171). The Trial Court refused to find that neither NEP nor any of its subsidiaries possessed on the date of substitution funds or credit to meet the January 1, 1932, financial requirements (Refusal 110; R. 171). The Trial Court refused to find that NEP's purpose in making the substitution was to use withdrawn securities as a basis of public financing to pay off bank loans (Refusal 111; R. 171). The Trial Court refused to find that respondent required and obtained increased commitments from NEP's subsidiaries to impress in its favor a prior lien on the earnings of such subsidiaries (Refusal 83; R. 165). The Trial Court refused to find that respondent preferred itself over debenture holders in recourse to the assets of the NEP system (Refusal 54; R. 158).

The Trial Court did find that respondent did not permit the substitution "in order to obtain profit for itself at the expense of debenture holders" (Finding 263; R. 117). The Trial Court further found that respondent "did not profit directly or indirectly from the pledge of the collateral released from under the trust indenture" (Finding 312; R. 126).

Petitioners state that the Trial Court held "that 'undivided loyalty' was not required" (Petition, p. 4). They

state that "not alone did this trustee concededly violate the rule of undivided loyalty" (Petition, p. 28). No citation has been given to support these statements. There was no such holding or concession. The Trial Court found that respondent "did not profit directly or indirectly" (Finding 312; R. 126), and the Trial Court refused to find that respondent "profited" (Refusal 258; R. 213) "stood to profit" (Refusal 257; R. 213), "benefitted" (Refusal 256; R. 212-213), or "expected to benefit" from the substitution (Refusal 268; R. 216).

Petitioners state that the Trial Court "predicated his release of Chase National, in holding, contrary to its concessions, that this National Bank was not a fiduciary" (Petition, p. 7). There is no basis in the record for any such statement. We urged on the motion to dismiss at the close of plaintiffs' case that the duties of a corporate trustee are measured and limited by the provisions of the indenture of trust (R. 1760). The Trial Court held as matter of law in its decision of June 29, 1936, not that respondent "was not a fiduciary" but that its duties, "as trustee, were measured and limited by the provisions of the trust indenture" (Conclusion V; R. 135). In affirming the judgment of the Trial Court, without opinion, the Appellate Division and in turn, the Court of Appeals likewise concluded that "the duties of defendant Chase National Bank, as trustee, were measured and limited by the provisions of the trust indenture".

Petitioners stated in their moving affidavit (R. 3709) on the motion for reargument and to amend the remittitur that "It is the fully considered view of affiant and his associates that the affirmance could only be reached by accepting the concept that the Chase National Bank acted herein as a non-fiduciary trustee". The Court of Appeals dissipated this "fully considered view of affiant and his associates"

by stating that the moving papers did not "present either authority or reason for changing our decision that the liability of the corporate trustee though acting as a fiduciary was limited by the terms of the trust agreement" (R. 3705) and cited *Benton* vs. *Safe Deposit Bank of Pottsville*, 255 N. Y. 260. Thus the Trial Court, the Appellate Division and the Court of Appeals concluded that respondent was a trustee and a fiduciary with its duties measured and limited by the provisions of the trust indenture.

Summary of Respondent's Argument.

(1) Concededly petitioners set up and raised alleged "Federal rights under a Federal statute" for the first time on the motion for reargument and to amend the remittitur. The Court of Appeals denied the motion for reargument, refused to pass upon the alleged "Federal rights under a Federal statute" and denied the motion to amend the remittitur so as to indicate that the alleged "Federal rights under a Federal statute" had been passed upon. Under such circumstances this Court will not entertain jurisdiction.

(2) Petitioners have not set up or claimed any title, right, privilege or immunity under the Constitution or any treaty or statute of the United States, and this Court is, therefore, without jurisdiction (28 USCA 344). The National Banking Act, the alleged statutory provisions involved, gives petitioners no title, right, privilege or immunity.

(3) The record refutes petitioners' claim that they were deprived of property without due process of law. The record shows that judgment was rendered in the regular course of judicial proceedings and in accord with well established law of the State of New York.

POINT I.

This Court is without jurisdiction. Concededly petitioners set up and raised alleged "Federal rights under a Federal statute" for the first time on the petition for rehearing to the highest appellate court of the State of New York. That Court denied the petition and refused to pass upon the alleged "Federal rights under a Federal statute".

The settled rule is that in order to give this Court jurisdiction to review the judgment of a state court the essential Federal question must have been especially set up in the state court at the proper time and in the proper manner; and further, that if first presented in a petition for rehearing, it comes too late unless the state court actually entertains the petition and passes upon the point. *Godchaux Co.* vs. *Estopinal*, 251 U. S. 179, 181.

It must affirmatively appear from the record that the highest appellate court of a state considered, passed upon and determined the Federal question. *Southwestern Bell Telephone Co.* vs. *Oklahoma*, 303 U. S. 206, 212, 213; *Consolidated Turnpike Co.* vs. *Norfolk & Oceanview Ry. Co.*, 228 U. S. 326, 333, 334. The statement by the highest appellate court of a state that it has passed upon a Federal question must be explicit and definite. *McGoldrick* vs. *Gulf Oil Corporation*, 309 U. S. 2, 3*; *Valley Steamship Company* vs. *Wattawa*, 244 U. S. 202, 205. The refusal by the highest appellate court of a state to entertain a Federal question not presented below is accepted by this Court as conclusive. *Chicago, Indianapolis & Louisville Ry. Co.* vs. *McGuire*, 196 U. S. 128, 132; *Pennsylvania Railroad Co.* vs. *Illinois Brick Co.*, 297 U. S. 447, 463.

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* Petition for rehearing based upon an amended remittitur explicitly showing decision on a Federal question, 282 N. Y. 622, was granted. See 309 U. S. 414, 416.

The burden is on petitioners to show that the Federal question was considered, passed upon and determined. There will be no presumption that the court considered the question. This Court's jurisdiction cannot be founded upon presumption or surmise. *Chicago, Indianapolis & Louisville Ry. Co.* vs. *McGuire,* 196 U. S. 128, 132; *Lynch* vs. *New York,* 293 U. S. 52, 54.

If the highest appellate court of a state refuses to entertain and dismisses a petition for rehearing without passing upon the Federal question, this Court will not review the state court's action. In other words, it must affirmatively appear that the Federal question was in fact passed upon in considering the motion for rehearing. Unless this is so this Court will not assume jurisdiction. *McCorquodale* vs. *State of Texas,* 211 U. S. 432, 437; *Forbes* vs. *State Council of Virginia,* 216 U. S. 396, 399; *Herndon* vs. *Georgia,* 295 U. S. 441, 443; *Southwestern Bell Telephone Co.* vs. *Oklahoma,* 303 U. S. 206, 212, 213.

Concededly the alleged "Federal rights under a Federal statute" were here set up and raised for the first time in the petition for rehearing and to amend the remittitur before the Court of Appeals, the highest appellate court of the State of New York (R. 3712, 3713; Petition, p. 5). The Court of Appeals denied the petition for rehearing in a one-sentence opinion, reading:

> "Ordered, that the said motion for reargument be and the same hereby is denied with ten dollars costs and necessary printing disbursements on the ground that it does not present either authority or reason for changing our decision that the liability of the corporate trustee though acting as a fiduciary was limited by the terms of the trust agreement (Benton *v.* Safe Deposit Bank of Pottsville, 255 N. Y. 260)." (R. 3705)

The opinion clearly shows that the Court of Appeals did not consider, pass upon and determine the alleged "Federal rights under a Federal statute." It based the denial upon the established law of the State of New York. This is the same law upon which the Trial Court and the Appellate Division predicated their decisions.

There was no "explicit" statement nor does it affirmatively appear from the decision of the Court of Appeals that the alleged "Federal rights under a Federal statute" were considered, passed upon and determined. On the contrary, that decision clearly indicates that the alleged "Federal rights under a Federal statute" were not considered, passed upon and determined.

At the same time that the Court of Appeals denied the petition for rehearing it refused to amend the remittitur at petitioners' request so as to show "that a Federal question or claim herein was presented, considered and passed upon" (R. 3707-3708). There was no way in which the Court of Appeals could more conclusively demonstrate that it had not considered, passed upon and determined the alleged "Federal rights under a Federal statute" and that it had refused to consider, pass upon and determine such alleged rights than by denying the motion to amend the remittitur. Indeed, this Court has taken cognizance of the practice of the Court of Appeals of the State of New York to amend remittiturs in cases where that court has considered, passed upon and determined Federal questions, *Lynch* vs. *N. Y.*, 293 U. S. 52, 55.

The record in this case shows affirmatively that the alleged "Federal rights under a Federal statute" were set up and raised for the first time on the petition for rehearing. The Court of Appeals has stated repeatedly that it will not pass upon issues not raised below and mentioned for the first time in the Court of Appeals, *Maloney* vs. *Hearst*

Hotels Corporation, 274 N. Y. 106, 111; *Persky* vs. *Bank of America Nat. Association,* 261 N. Y. 212; *Nicholson* vs. *Greeley Square Hotel Co.,* 227 N. Y. 345, 349; *Blair* vs. *Flack,* 141 N. Y. 53, 56, 58. It not only followed its established practice in this case, but expressly refused to amend the remittitur to show that it had considered, passed upon and determined petitioners alleged "Federal rights under a Federal statute".

Petitioners recognize these facts for they go one step further and argue that this case comes within an exception to the general rule. They say that where the highest appellate court of a state reverses or affirms a judgment upon a new theory or upon construction of a statute which for the first time threatens rights under the Constitution, then the Federal question is timely raised on petition for rehearing whether or not the highest appellate court entertains or passes upon the new issue. They cite *Herndon* vs. *Georgia, supra,* and other cases as authority. They ignore the fact that this is not a case where the alleged "Federal rights under a Federal statute" arise from the unanticipated act of the highest State court by its affirmance of a judgment of the lower court upon a theory or construction of statute which threatened for the first time rights under the Constitution or statutes of the United States.

In our case there was only one opinion. That was the opinion of the Trial Court. Both the Appellate Division and the Court of Appeals affirmed the decision of the Trial Court without opinion, and not on any new theory or construction of statute. Moreover, the decision of the Court of Appeals in denying the petition for rehearing shows that that court affirmed the decision of the Trial Court upon the same theory and that it did not adopt "the concept of a non-fiduciary trustee". This fact is emphasized by the language of the decision of the Court of Appeals.

Petitioners had urged on the petition for rehearing that the Court of Appeals in affirming the judgment of the Appellate Division, which in turn had affirmed the judgment of the Trial Court, was adopting "the concept of a non-fiduciary trustee" (R. 3713). The Court of Appeals refuted petitioners' contention in plain and unmistakable language. It said that the petition did not "present either authority or reason for changing our decision that the liability of the corporate trustee though acting as a fiduciary was limited by the terms of the trust agreement" (R. 3705). It cited *Benton* vs. *Safe Deposit Bank of Pottsville,* 255 N. Y. 260. This is an authority upon which the Trial Court's decision was predicated. It thus clearly appears that there was no threat to petitioner's rights under the Constitution or statutes of the United States by virtue of any decision of the Court of Appeals.

During the two and one-half months that intervened between the rendition of the Trial Court's opinion and the signing of the Trial Court's decision, petitioners had ample opportunity to decide upon and formulate their alleged "Federal rights under a Federal statute." They were given a further opportunity to decide upon and formulate their alleged "Federal rights under a Federal statute" in preparing their exceptions to the findings of the Trial Court.

The Trial Court held as matter of law that "The duties of defendant The Chase National Bank, as trustee, were measured and limited by the provisions of the trust indenture" (Conclusion V; R. 135). Petitioners' exception to that conclusion was "on the ground that that conclusion of law is without any evidence tending to sustain it and contrary to law" (Exception 124; R. 296). After the Trial Court had rendered its opinion, petitioners submitted to

the Trial Court 316 proposed findings of fact (R. 217) and 37 proposed conclusions of law (R. 222). They filed 349 exceptions to the decision of the Trial Court (R. 329). Nowhere in their proposed findings, conclusions or exceptions did they make mention of their alleged "Federal rights under a Federal statute". They did not set up or raise their alleged "Federal rights under a Federal statute" in the Trial Court, in the Appellate Division or even in the Court of Appeals until after the Court of Appeals had rendered its judgment of affirmance. They set up and raised the question of their alleged "Federal rights under a Federal statute" for the first time on the petition for rehearing. The Court of Appeals not only did not consider, pass upon and determine that question, but in clear and unequivocal language indicated that it refused to do so.

We submit that on the basis of the record in this case and on the basis of this Court's decisions petitioners' alleged "Federal rights under a Federal statute" have not been timely raised.

POINT II.

Petitioners have shown no right or privilege under any Federal statute so as to confer jurisdiction upon this Court.

Petitioners claim that the jurisdiction of this Court is sustained since they specifically set up "Federal rights under a Federal statute: *National Banking Act,* 12 U. S. C. A.;" (Petition, p. 3).

Nowhere in the petition are the rights which petitioners claim under that statute specified or defined. They cite only Section 11(k) of the Federal Reserve Act (12 U. S.

C. A. 248k), which authorized the Board of Governors of the Federal Reserve System:

> "To grant by special permit to national banks applying therefor, when not in contravention of State or local law, the right to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the State in which the national bank is located.
>
> "Whenever the laws of such State authorize or permit the exercise of any or all of the foregoing powers by State banks, trust companies, or other corporations which compete with national banks, the granting to and the exercise of such powers by national banks shall not be deemed to be in contravention of State or local law within the meaning of this chapter."

Petitioners argue that in some way (which they do not explain) the fact that Congress has granted to national banks the corporate power to compete with state institutions in the corporate fiduciary field places upon national banks duties and liabilities different from and greater than those assumed by state institutions acting in the same fiduciary capacities, and in the instant case, different from and greater than the duties and liabilities assumed by The Equitable Trust Company of New York when it became trustee of the same trust indenture.

Petitioners point to no portion of Section 11(k) which either expressly or impliedly provides that national banks shall have duties and liabilities different from and greater

than those assumed by state institutions acting in the same fiduciary capacities. They cite a great number of cases, beginning with *M'Culloch* vs. *Maryland*, but the cases cited all have to do either with the power of Congress to create national banks: *M'Culloch* vs. *Maryland*, *Osborn* vs. *Bank of United States*, *First National Bank* vs. *Fellows*, *Missouri ex rel. Burnes National Bank* vs. *Duncan*, or the power of states to tax or in other ways to impair the functions of national banks: *Ex Parte Worcester County National Bank*, *Easton* vs. *Iowa*, *Colorado National Bank* vs. *Bedford*, or involve the violation of express limitations on powers granted to national banks, or the liabilities and immunities of the directors thereof: *Yates* vs. *Jones National Bank*, *Jones National Bank* vs. *Yates*, *Awotin* vs. *Atlas Exchange National Bank*, *Deitrich* vs. *Greaney*, *Inland Waterways Corporation* vs. *Young*, and *City of Yonkers* vs. *Downey*.

It is apparent from a reading of Section 11(k) of the Federal Reserve Act that it has not the slightest relevancy. The section confers upon national banks the corporate power to compete with state institutions in the corporate fiduciary field. The fact that petitioners refer to a Federal statute and claim a right thereunder without more is not sufficient to meet the jurisdictional requirements of this Court. *Chicago, Rock Island & Pacific Ry. Co.* vs. *Maucher*, 248 U. S. 359. In that case plaintiff in error, to support his right to contract against liability, pointed to the enactment of the Carmack Amendment (Act of June 29, 1906, c. 3591, § 7, 34 Stat. 584, 595) which dealt with the power of carriers to contract with respect to limitation of liability on shipments of property. The state trial court had held that liability was to be determined by the

law of Nebraska and ruled against plaintiff in error. This Court dismissed the writ of error, holding that the case presented no substantial federal question, and pointed out that the statute cited related only to shipments of property and not to transportation of persons.

In the instant case, petitioners refer to Section 11(k) of the Federal Reserve Act which grants corporate power to national banks so that they may compete with state institutions in the corporate fiduciary field. This Court has held on prior occasions that Section 11(k) of the Federal Reserve Act was adopted in order to permit national banks to compete with state institutions. *First National Bank* vs. *Fellows ex rel. Union Trust Company,* 244 U. S. 416; *Missouri ex rel. Burnes National Bank* vs. *Duncan,* 265 U. S. 17. Moreover, in these cases, this Court has held expressly that although Section 11(k) of the Federal Reserve Act granted to national banks the corporate power to act as corporate fiduciaries, the regulation and administration of corporate fiduciary activities was subject to state law and regulation. Thus, in *First National Bank* vs. *Fellows ex rel. Union Trust Company, supra,* this Court said at page 426:

> "Of course as the general subject of regulating the character of business just referred to is peculiarly within state administrative control, state regulations for the conduct of such business, if not discriminatory or so unreasonable as to justify the conclusion that they necessarily would so operate, would be controlling upon banks chartered by Congress when they came in virtue of authority conferred upon them by Congress to exert such particular powers. And these considerations clearly were in the legislative mind when it enacted the statute in question."

In *Ex Parte Worcester County National Bank,* 279 U. S. 347, this Court said, in passing upon Section 3 of the Act of Congress of February 25, 1927, which permitted the consolidation of national banks and state institutions:

> "We think § 3 enjoins upon the national bank complete conformity with the Massachusetts law in its conduct of estates of deceased persons when acting as trustee or administrator thereof." (P. 360)

In *Union National Bank* vs. *Louisville, New Albany & Chicago Ry. Co.,* 163 U. S. 325, this Court recognized the distinction between the grant of power by act of Congress, and the right to have an equal administration of a rule established by the state court under a statute granting to national banks the right to charge interest at the same rate as that charged by the states in which they operated. It was there stated:

> "A sufficient answer is that the true construction of state legislation is a matter of state jurisprudence, and while the right of the national bank springs from the act of Congress, yet it is only a right to have an equal administration of the rule established by the state law. It does not involve a reservation to the national courts of the authority to determine adversely to the state courts what is the rule as to interest prescribed by the state law, but only to see that such rule is equally enforced in favor of national banks. The decision here was not against any equality of right, but only a determination of the meaning of the state law as applied to all creditors. It therefore denied no rights given by the Federal statute and involved no judgment adverse to plaintiff as to its meaning and effect." (P. 331)

In short, the purpose and object of Congress in enacting the National Banking Act was to leave national banks as

to their contracts in general under the operation of state law, and thereby invest them as Federal agencies with local strength, while, at the same time, preserving them from undue state interference.

Thus there is not even the possibility of any conflict between Section 11(k) of the Federal Reserve Act and the decisions of the New York State courts that the duties and liabilities of corporate trustees, whether national banks or state institutions, are measured and limited by the terms of the trust indenture. To adopt the language of this Court in *Chicago, Rock Island & Pacific Ry. Co.* vs. *Maucher, supra,* the language of Section 11(k) "is so clear as to leave no ground for the contention that Congress intended to deal with" the duties and liabilities of national banks acting as corporate trustees.

In an attempt to show that Section 11(k) of the Federal Reserve Act was intended to impose upon national banks higher duties than those imposed on state banks by state law, petitioners quote a portion of House Report No. 479, 65th Congress, 2nd Session, which preceded the adoption of the 1918 Amendment of Section 11(k) (Petition, p. 30). The provisions of the amendment to which the House Report referred to as "these provisions" related to requirements as to segregation of assets and the keeping of records. Petitioners, in quoting the House Report omit, without indicating the omission, the last half of a sentence which they purport to quote. The entire sentence reads:

> "These provisions are intended to impose safeguards upon the exercise of these fiduciary powers by national banks, *and to have national banks in the exercise of these powers conform as fully as is practicable with state requirements.*"

The portion omitted entirely destroys the inference petitioners seek to draw.

We submit that in pointing to Section 11(k) of the Federal Reserve Act, petitioners have not shown a right under Federal statute sufficient to give this Court jurisdiction. The right asserted is without substance as is indicated not only by the language of the section itself, but by the historical background of the section.

Apparently forsaking their argument that Section 11(k) gives them some right, petitioners frequently refer to "federal law and policy", and suggest that such law requires greater duties and greater liability of a national bank which succeeds a state bank as corporate trustee than that which was required of the state bank while it was acting in the same capacity and under the same instrument. It is thus stated that the state court's decision in the instant case permitted respondent to limit its duties and liabilities by the trust indenture and that such holding was "in conflict with paramount controlling federal law and policy." But nowhere in the entire petition is such federal law or policy defined or specified. On the contrary petitioners concede that there are no precedents of this Court distinguishing between the duties and liabilities of a state bank acting as trustee under a given instrument and the duties and liabilities of a national bank succeeding the state bank as corporate trustee under the same instrument. Petitioners say (Petition, p. 34):

> "Again and again this Court has considered and defined the powers, rights, privileges and immunities of National Banks but never their fiduciary duties, obligations or disabilities. This case then is one of first impression involving the construction, application and interpretation of such duties and disabilities of a National Bank permitted under Federal law to act as a 'trustee' 'or in any other fiduciary capacity'."

The Trust Indenture Act of 1939, 53 Stat. 1149 (15 U. S. C. A. 77aaa) conclusively shows that there was no federal law or federal policy prohibiting national banks in competition with state banks from measuring and limiting their duties in the trust indenture. The Trust Indenture Act was designed to place all banks acting as corporate trustees, whether national or state, under the regulation of Federal statute. The enactment of that bill is conclusive demonstration that no "federal law or policy" existed governing the powers, duties and liabilities of national banks as trustees under corporate indentures.

POINT III.

Petitioners have not been deprived of property without due process of law.

The second ground urged by petitioners to sustain jurisdiction is that the decision below was arbitrary and capricious, in violation of settled principles of law, contrary to undisputed facts, and in disregard of formal concessions of respondent, and that therefore petitioners were unconstitutionally deprived of their property without due process of law. Petitioners cite three cases, *Scott* vs. *McNeal*, 154 U. S. 34, where a state court had refused to return property conveyed by the administrator of a person later found to be living; *Postal Telegraph Cable Co.* vs. *Newport*, 247 U. S. 464, where the state court had held under the doctrine of *res adjudicata* that a litigant was bound by the principle of a case to which the litigant was not a party, and finally, *Williams* v. *Tooke*, 108 F. (2d) 758, where a litigant sought to have a federal district court review a determination of the highest state court of Texas. No further attempt is made in the petition to

show that the decision of the Trial Court in our case was arbitrary or capricious.

This case was decided under the well established law of the State of New York and in conformity with a long line of New York decisions.

Hunsberger vs. *Guaranty Trust Co.* (1914), 164 N. Y. App. Div. 740, aff'd 218 N. Y. 742;

Green vs. *Title Guarantee and Trust Co.* (1928), 223 N. Y. App. Div. 12, aff'd 248 N. Y. 627;

Benton vs. *Safe Deposit Bank of Pottsville* (1931), 255 N. Y. 260;

Greene vs. *Continental Bank and Trust Co.* (1935), 267 N. Y. 519;

Ansbacher vs. *New York Trust Co.* (1939), 280 N. Y. 79.

The Restatement of the Law of Trusts expressly approves the doctrine upon which this case was decided. Thus in Section 174, Com. d, it is stated:

> "d. *Standard fixed by terms of the trust.* By the terms of the trust the requirement of care and skill may be relaxed or modified. A provision in the terms of the trust fixing a standard of care or skill lower than that which would otherwise be required of a trustee is strictly construed."

All that was decided by the state court and all that is involved in this case is the construction of a trust indenture, and the liability of the trustee thereunder. This is not a question of federal common law, for this Court has held that there is no such law,* but of state law applicable to contracts, trusts and torts.

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* *Erie R. R. Co.* vs. *Tompkins*, 304 U. S. 64, 78; *Ruhlin* vs. *New York Life Insurance Co.*, 304 U. S. 202, 205.

Capital National Bank vs. *First National Bank of Cadiz*, 172 U. S. 425, is a pertinent authority. There one national bank brought suit against another national bank and its receiver for the recovery of funds collected from notes transmitted to the latter for collection and remittance. The Nebraska trial court found that the moneys collected constituted a trust fund and directed payment to the plaintiff by the receiver. The receiver's motion for a new trial was overruled and the case was taken to the Supreme Court of Nebraska, which affirmed the judgment of the trial court. Thereupon the receiver applied for a rehearing in the Supreme Court of Nebraska on the ground, among others, that the decree establishing the trust fund and declaring a lien would work a preference and priority to certain creditors and was "in violation of the provisions of the national bank act". The Supreme Court of the United States, in holding that no federal question was involved and that it had no jurisdiction, said:

> "In our opinion no Federal right was specially set up or claimed in this case at the proper time or in the proper way; nor was any such right in issue and necessarily determined; but the judgment rested on non-Federal grounds entirely sufficient to support it.
>
> "The record discloses no Federal question asserted in terms save in the application to the Supreme Court for a rehearing, when the suggestion came too late.
>
> "The petition did, indeed, allege that the Capital National Bank was organized under the banking act, and that a receiver was appointed, who took possession of the bank's assets and of all trusts and moneys held by it in a fiduciary capacity, and the answer admitted these averments, respecting which there was no controversy, yet no right to appropriate trust funds

was claimed by defendant under any law of the United States, nor was it asserted that any judgment which might be rendered for plaintiff would be in contravention of any provision of the banking act.

* * * * *

"This rule [that right must be claimed before judgment] was not complied with here, nor was any Federal question in terms decided, while on the contrary the judgment was explicitly rested on non-Federal grounds.

"The contention of plaintiff was that the Capital National Bank had money in its hands which belonged to plaintiff; did not belong to the bank; had never formed part of its assets; and was held by the bank in trust for plaintiff.

"The right to the money was considered by the trial court in the light of general equitable principles applicable on the facts, and the court adjudged that the money constituted a trust fund to which plaintiff was entitled.

* * * * *

"We know of no provision of the banking act which assumes to appropriate trust funds in the possession of insolvent banks, or other property in their possession to which they have no title, and it is clear that the state courts had jurisdiction to determine whether this money was or was not a trust fund belonging to plaintiff.

"The receiver made no effort to remove the litigation to the Circuit Court, contested the issues on a general denial, and set up no claim of a right under Federal statutes withdrawing the case from the operation of general law.

"In these circumstances the result is that this court has no jurisdiction to revise the judgment of the Supreme Court of Nebraska, * * *." (pp. 431-434)

Conclusion.

It is respectfully submitted that

1. The alleged "Federal rights under a Federal statute" were not timely raised;

2. Petitioners have shown no title, right, privilege or immunity under the Constitution, or any treaty or statute of the United States;

3. The record affirmatively shows that the decisions of the state courts did not deprive petitioners of property without due process of law; and

4. The petition for a writ of certiorari to the Supreme Court of the State of New York should be denied.

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